BELLSOUTH APPENDIX

TAB 23

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Implementation of requirements arising from Federal Communications Commission triennial UNE review: Local Circuit Switching for Mass Market Customers.	)))))	Docket No. 030851-TP

PREFILED REBUTTAL TESTIMONY OF

MICHAEL P. GALLAGHER

SUBMITTED BY:

FDN COMMUNICATIONS

Filed January 7, 2004

Q. Please state your name and address.

A. My name is Michael P. Gallagher. My business address is 390 North Orange Avenue, Suite 2000, Orlando, Florida, 32801.

Q. Who do you work for?

A. I am Chief Executive Officer of Florida Digital Network, Inc. ("FDN").

Q. What are your responsibilities as CEO of FDN?

A. As CEO of FDN, I am ultimately responsible to the shareholders for all aspects of FDN's operations and performance. On a management level, FDN's President & Chief Operating Officer, Chief Financial Officer and General Counsel report directly to me; FDN's Engineering & Operations, Customer Service, and Sales Vice Presidents and its Chief Technology Officer report to the President & COO, who is also in charge of FDN's Marketing functions. I am involved in the day-to-day business dealings of the company and the decision-making on everything from marketing and sales strategies, product development, network architecture and deployment, financing, human resources, customer care, regulatory changes, etc.

Q. Please describe your education and your work experience in the telecommunications sector.

A. I received a B.S. Degree in Mathematics with a minor in Physics from Rollins College.

Prior to co-founding FDN in 1998, I served as Regional Vice President for Brooks Fiber Communications where I had overall responsibility for operations, engineering, finance and sales in the State of

Texas. Brooks Fiber Communications merged into WorldCom on January 31, 1998. Prior to holding the VP position at Brooks, I was president of Metro Access Networks (MAN), a second-generation CLEC in Texas founded in 1993. At MAN, I developed all business strategies, designed network architecture, secured contracts with the company's original customer base, and had overall responsibility for operations and performance. MAN merged into Brooks Fiber in March 1997. Prior to MAN, I worked for Intermedia Communications and Williams Telecommunications Group (WilTel) as sales representative securing contracts with large commercial customers.

Q. Have you previously testified in a regulatory proceeding before a state utility commission, the FCC or a hearing officer?

A. Yes. I have testified before this Commission in Docket No. 010098-TP (FDN's Arbitration case with BellSouth), Docket No. 990649A-TP (the 120-day portion of BellSouth's UNE cost case), and Docket No. 020119-TP (FDN's Complaint against BellSouth for Anticompetitive Promotion Practices).

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. FDN believes the Commission should have a balanced view of the unbundled network element (UNE) switching impairment issue. FDN utilizes, and has utilized since its inception in 1998, a UNE-L strategy to provide service mostly to small-to-medium sized businesses, by leasing UNE

loops from incumbent carriers and utilizing FDN's own Class 5 switches, as I will describe later. FDN believes it operates as the federal Telecommunications Act of 1996 (the "Act") contemplated competition would evolve, i.e., where competing carriers invest in their own facilities and infrastructure and have guaranteed access, for a fee, to certain ILEC property/elements only where such property/elements could not be practically replicated. Indeed, switching has been and still is readily available to any one willing to purchase a Class 5 type device. Advances in soft switch technology also make non-Class 5 switching realistic and have led to lower overall switching costs. However, the focus of my rebuttal testimony will be on a few key points summarized as follows.

First, for purposes of this proceeding, FDN considers itself a self-provisioned switch "trigger" company as defined by the TRO. FDN believes many of the interpretative twists that others argue the Commission should add to the TRO are not supportable. Further, FDN believes that the hot cut process of the ILECs works well for the most part. FDN has performed thousands of hot cuts with Florida's ILECs and currently performs over two hundred hot cuts for DS-0's per day. Finally, if the Commission finds impairment stemming from the hot cut process and therefore establishes a batch process, FDN maintains that any batch process should at least incorporate certain features, namely: (1) the batch process will, as required by the TRO, cover hot cuts of the type FDN performs daily and not just one-time conversions of UNE-P to UNE-L, (2) batch rates are structured such that

there is a significant and real overall reduction in NRCs, and (3) batch processes reflect operational efficiencies and not needlessly extend hot cut intervals. If the Commission endeavors to cure any impairment finding or address perceived flaws associated with hot cuts through a more direct approach or means other than a batch process, FDN would support those efforts.

FDN believes that as the leading UNE-L based provider in Florida, FDN has a unique vantage point that will be valuable to the Commission in this proceeding and that FDN's input should be useful in weighing some of the claims that the parties have made in their direct testimony.

Q. Please briefly describe FDN's operations.

A. As I mentioned, FDN is a facilities-based/UNE-L CLEC. FDN is also an IXC, a data services provider (both dial-up and dedicated), and FDN offers ISP and other Internet services. FDN was founded in 1998 with the mission of offering packaged services (local, long distance and Internet) to small- and medium-sized businesses. FDN launched operations in Orlando in April 1999 and expanded to Fort Lauderdale in May 1999 and to Jacksonville in June 1999. A second round of expansion in West Palm Beach, Miami and the Tampa Bay area was completed in the first quarter of 2000.

FDN owns and operates Class 5 Nortel DMS-500 central office switches in Orlando, Tampa, Jacksonville, and Ft. Lauderdale. FDN's switches are connected by fiber optic cable owned or leased by FDN to

nearby incumbent local exchange carrier (or "ILEC") tandem switches. FDN leases collocation space in over 100 ILEC wire centers throughout the state. Remote DLC/DSLAM equipment is installed at these collocation sites, and from these sites FDN accesses ILEC UNE loops. Connectivity from the collocation sites to the central ILEC tandem switch is via FDN's own fiber or leased DS-1 or DS-3 circuits. As I mentioned, FDN relies upon its rights under the Act to obtain "last mile" access to Florida consumers through the purchase of UNEs from BellSouth, Verizon and Sprint.

FDN uses BellSouth's TAG gateway for electronic ordering and is in the process of migrating to EDI. With systems and software FDN developed on its own, FDN accesses BellSouth customer service records ("CSRs") electronically, and FDN transmits virtually all of its local service requests ("LSRs") to BellSouth electronically. Most of FDN's orders to Verizon are done on a partially mechanized basis, and FDN utilizes Verizon's Wholesale Provisioning Tracking System (WPTS) for tracking service activities. The vast majority of FDN's LSRs to BellSouth, Verizon and Sprint are for 2-wire voice grade UNE loops.

Q. Several ALEC witnesses (Mr. Gillan 52 – 65 and Mr. Reith (virtually throughout his direct)) laud the success of the UNE-P business model, argue that unbundling promotes investment and criticize what they see as the failure of the UNE-L business model. Do you agree with their testimony?

A. No. FDN maintains that this sort of testimony is not relevant to the tasks which the FCC has delegated to the state Commissions. The FCC, after wading through the incentive, rights and benefits arguments, and taking into account the intent of the Act and the prior decisions of the courts, already made the choice on what the states must do and what the states are to consider. The FCC did not leave the door open for states to consider policy arguments like those made by Mr. Gillan and Mr. Reith, or, for that matter, to consider any ILEC arguments on the same subject. If, contrary to the TRO, the Commission considers such arguments, FDN, as a UNE-L provider which has invested significant sums of money in its own switching, network, infrastructure and OSS and which competes against UNE-P for limited capital in the emerging telecommunications sector and competes against UNE-P for customers, would naturally take an opposing stance.

Q. A number of the ALEC witnesses (Mr. Gillan on pages 35 – 51, and Dr. Staihr on pages 11 – 23, for example) argue that the TRO should be interpreted in ways so as to limit which CLECs may be deemed a "trigger" company. Do you have any comment?

A. Yes. First, I believe that FDN is indeed a trigger company in the markets in which FDN operates.

I can verify the confidential information that FDN provided to BellSouth and confirm BellSouth witness Tipton's correct reliance on same in reaching her conclusions regarding the TRO triggers. Similarly, I can confirm Verizon witness Fulp's reliance on FDN's trigger presence in the

Verizon-defined market. FDN serves a significant number of customers with one line, two lines, and three lines in its markets. So even if the "cross-over" between "mass market" customer and "enterprise" customers were as low as BellSouth advocates (at three lines and below), FDN would be a trigger company because FDN has numerous customers everywhere it serves with three lines and below, including some residential customers. At this time, FDN does not disagree with how BellSouth or Verizon have defined geographic markets for purposes of this proceeding.

FDN maintains that the Commission should critically evaluate the TRO trigger test embellishments advocated by witnesses such as Mr. Gillan and Dr. Staihr in their direct testimony. Notably, Mr. Gillan goes so far as to say on page 51, line 22, of his direct, "It is up to the Commission to put flesh on the bones, in the form of informed analysis of the trigger criteria established by the FCC." FDN does not believe that it is permissible for the Commission to go that far. Certainly, there are instances where an FCC directive may be unclear and require interpretation. It is not uncommon for the Commission to undertake a detailed analysis of the language of an FCC ruling as applied to a particular set of facts before the Commission. However, a number of the Gillan/Staihr recommendations go beyond mere interpretation and amounts to inappropriate addition.

For instance, both Gillan and Staihr argue that any switch counted against the trigger must serve "predominantly" mass market customers, not enterprise customers. Dr. Staihr even states that the Commission should

evaluate the capacity of the switch and determine what percentage of the capacity is devoted to mass market customers versus enterprise customers. Neither a predominance test nor Dr. Staihr's formula approach are part of the TRO or FCC rules, so the Commission should refrain from considering such arguments. Further, Mr. Gillan suggests the Commission make an "informed assessment of the viability" of the trigger companies' viability, despite his acknowledgment that the TRO bars states from evaluating individual trigger companies. Again, the Commission should not inappropriately embellish the TRO by adding requirements such as these or Dr. Staihr's recommendation that the trigger company be capable of serving "throughout" the defined market, however the market be defined. In sum, if the FCC intended to require some of the things these witness advocate, the FCC would have directly said so in the TRO and accompanying rules, but it did not.

Q. Several CLEC witnesses (including AT&T witness Van de Water, MCI witness Lichtenberg, and Supra Stahly) argue, essentially, that the hot cut process of the ILECs is a source of operational impairment, while the BellSouth and Verizon witnesses (including BellSouth witnesses Ruscilli, Ainsworth and Varner and the "Verizon Panel") argue just the opposite. With whom, if anyone, does FDN agree?

A. As a UNE-L based CLEC that performs over two hundred hot cuts for DS-0 loops daily and has performed more hot cuts than any other single CLEC in the state, FDN would be hard pressed to say that the hot cut process does not work well. BellSouth witness Ruscilli states in his direct that as of

October 2003, there were 156,746 lines in Florida served by a combination of a BellSouth unbundled loop and a CLEC switch. (Ruscilli Direct, page 13, line 21.) FDN believes it constitutes about two-thirds of that total. Further, FDN believes it has performed more voice grade loop hot cuts in Verizon Florida and Sprint Florida than any other CLEC as well.

It should be noted the direct testimony of the ILECs and CLECs presents the Commission with a preliminary question when evaluating the hot cut process: By what standard is the hot cut process to be judged? BellSouth argues that the hot cut process has already been tried and tested in the 271 proceeding and that, with a few modifications (and adding scale for UNE-P conversions), the existing processes are good enough. The CLECs argue that hot cuts must meet the same service intervals and standards as a UNE-P or PIC order. This proposed standard, some of the CLEC witnesses frankly admit, could not realistically be achieved, not in the confines of this nine-month proceeding anyway. FDN is not necessarily advocating one or the other standard, but suggests that since the hot cut process works well for the most part, when and if it does not work, the CLEC should be adequately compensated for, and the ILEC strongly incented to, cure problem areas.

FDN suggests that ILECs would be incented to cure perceived flaws in the hot cut process if the Commission tilted key performance metrics and compensation payments to focus more on the realities of a UNE-L world rather than a UNE-P world. When an ILEC errs in processing a UNE-P order, the conversion occurs earlier or later than scheduled, a customer has to

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TAB 24

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Implementation of requirements arising from Federal Communications Commission triennial UNE review: Local Circuit Switching for Mass Market Customers.	)))))	Docket No. 030851-TP

PREFILED SURREBUTTAL TESTIMONY OF

MICHAEL P. GALLAGHER

SUBMITTED BY:

FDN COMMUNICATIONS

Filed January 28, 2004

Q. Please state your name and address.

A. My name is Michael P. Gallagher. My business address is 390 North Orange Avenue, Suite 2000, Orlando, Florida, 32801.

Q. Are you the same Michael P. Gallagher who provided rebuttal testimony in this proceeding?

A. Yes.

Q. What is the purpose of your surrebuttal testimony in this proceeding?

A. The purpose of my surrebuttal is to address the supplemental rebuttal filed by FCCA witness Gillan on January 22, 2004, and briefly comment on certain aspects of the rebuttal testimony of the BellSouth and Verizon witnesses regarding batch processing.

Q. On pages 2 through 5 of his supplemental rebuttal and in Confidential Exhibit No. __ (JPG-10), FCCA witness Gillan alleges that BellSouth's named trigger companies are not "actively" providing service to the mass market and do not have sufficient market share to justify a finding of nonimpairment for local circuit switching. Do you agree with Mr. Gillan?

A. I do not believe the FDN/Mpower numbers Mr. Gillan used are what he says they are or show what he claims they show. Further, as I explained in my rebuttal testimony, FDN is a trigger company under the TRO and the

embellishments witnesses like Mr. Gillan suggest the Commission should make to the trigger tests of the TRO are unwarranted.

Mr. Gillan supplemental rebuttal was filed January 22 and surrebuttal in this case was due on January 28. The FCCA did provide FDN with the FDN/Mpower numbers included in Mr. Gillan's supplemental exhibit. However, prior to filing this surrebuttal, FDN had not obtained a detailed explanation of what is included in the confidential data Mr. Gillan says he relied on in arriving at those numbers, namely BellSouth's responses to Item No. 3 of an AT&T Subpoena and AT&T Interrogatory No. 125. Once an explanation of the underlying data is received and reviewed, FDN may supplement this surrebuttal testimony. Therefore, while FDN is without the benefit of knowing precisely what data BellSouth provided AT&T, FDN can regardless maintain that the confidential data Mr. Gillan reports for FDN/Mpower in his supplemental rebuttal is not what Mr. Gillan says it is.

Mr. Gillan reports and relies on numbers for "In-service UNE Loops." But Mr. Gillan's numbers for FDN/Mpower cannot be reconciled with what FDN reported to the PSC for FDN/Mpower in FDN's confidential response to the staff's data request; and the figures in FDN's response to the data request reflect what FDN knows to be correct. As I stated in my rebuttal, FDN serves approximately two-thirds of the total UNE-L loops BellSouth witness Ruscilli reported in his direct testimony -- more than three times the number Mr. Gillan reports for FDN in his supplemental rebuttal. Considering

that the information Mr. Gillan cites for FDN is not correct, the rest of his analysis and conclusions are likewise probably incorrect.

In any case, as I indicated in my rebuttal, Mr. Gillan's arguments (and other CLEC witness arguments) that trigger companies must meet additional criteria, such as meeting unspecified growth criteria to be "actively" providing service or meeting some kind of threshold market share criteria, are not appropriate considerations under the TRO.

Q. BellSouth witness Ainsworth states on page 3, lines 11 – 14, and on page 11, lines 17 – 18, of his rebuttal that BellSouth designated the batch hot cut process to convert UNE-P arrangements "given the predominance of UNE-P arrangements" and because the TRO more or less intended the batch process only for UNE-P conversions. Does FDN agree?

A. No. As I mentioned in my rebuttal testimony, a batch process is defined in the TRO rules as:

> [A] process by which the incumbent LEC simultaneously migrates two or more loops **from one carrier's local circuit switch to another carrier's local circuit switch,** giving rise to operational and economic efficiencies not available when migrating loops **from one carrier's local circuit switch to another carrier's local circuit switch** on a line-by-line basis.

(Emphasis added.) The rule does not restrict batch processing to one-time conversions from UNE-P to UNE-L. If the FCC meant for the state

BELLSOUTH APPENDIX

TAB 25

MEMORANDUM

TO: All Commissioners, Tom Bond

FROM: John Kaduk, Public Utilities Engineer, Telecommunications

DATE: September 14, 2004

RE: DOCKET NO. 19144-U: **Petition of DIECA Communications, Inc., d/b/a Covad Communications Company for Arbitration of Interconnection Agreement Amendment with BellSouth Telecommunications, Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996.** Consideration of BellSouth's Obligation to Provide Line Sharing After October 2004.

Background:

On June 23, 2004, DIECA Communications, Inc., d/b/a Covad Communications Company ("Covad") filed a Petition for Arbitration against BellSouth Telecommunications, Inc. ("BellSouth"). The August 21, 2003 Triennial Review Order ("TRO") issued by the Federal Communications Commission ("FCC") determined that line sharing was no longer an unbundled network element that incumbent local exchange carriers ("ILECs") were required to offer pursuant to Section 251, and, consequently, established a transitional mechanism for companies with existing line sharing arrangements. The Petition by Covad requests that the Georgia Public Service Commission ("Commission") resolve the single issue of whether BellSouth is obligated to continue to provide line-sharing under Section 271 of the Act.

On July 19, 2004, BellSouth filed its Response to Covad's Initial Petition for Arbitration. BellSouth states that, in addition to the issue raised by Covad, there are other issues surrounding the FCC's decision, which also need to be resolved.

On July 27, 2004, BellSouth filed a Motion for Summary Disposition and Expedited Relief in support of its previously filed Response.

On August 13, 2004, the parties filed a proposed joint procedural and scheduling order for the filing of briefs on or before September 3, 2004. The issue to be briefed as proposed by the parties was:

Q: Is BellSouth obligated to provide Covad access to line sharing after October 2004?

The parties agreed that the other issues raised by BellSouth would be addressed at a later date if an agreement was not reached by the time the preliminary issue was

decided upon by the Commission.

On August 17, the Commission approved Staff's recommendation to assign the matter to a Hearing Officer to consolidate the issues presented by both parties and establish a procedural and scheduling order.

Recommendation:

The preliminary issue of whether BellSouth is obligated to provide line-sharing after October 1, 2004 is directly related to issues that will be part of the Commission's generic docket initiated on July 6, 2004 in Docket No. 19341-U. The generic docket arose out of the petition by CompSouth in Docket 19003-U and the joint petition of XO Georgia, Inc. and Allegiance Telecom of Georgia, Inc. ("Joint Petitioners") in Docket 18943-U. These petitions sought declaratory rulings requiring BellSouth to honor its existing interconnection agreements. In creating a generic proceeding, the Commission ordered parties to file proposed issues within sixty days from the date of the order initiating the docket.

The Joint Petitioners in Docket No. 19341-U requested that the Commission initiate a generic proceeding "to determine issues of general applicability." (Joint Petition, p. 4). The Joint Petitioners stated that the generic proceeding should address: (a) whether the D.C. Circuit Court of Appeals vacatur represents a "change in law", (b) whether BellSouth is obligated to provide UNEs under section 271 of the Telecommunications Act of 1996, and (c) whether BellSouth is obligated to provide UNEs under Georgia State Law. In response, BellSouth stated that it will not unilaterally violate its interconnection agreements, but that it does intend to seek modification of its agreements through the "change in law" provisions of those agreements. (Docket No. 18943-U Response, pp. 1-2; Docket No. 19003-U Response, p. 2). However, BellSouth agreed that a generic proceeding is appropriate in these circumstances, rather than the Commission "resolving issues of industry-wide applicability on a case-by-case basis."

In the generic proceeding, the Commission will determine, in part, whether a Section 251 UNE must still be unbundled by the ILEC under Section 271 if it has been removed from Section 251. Section 271 requires ILECs to provide a checklist of UNEs to competitive LECs in order to receive long distance authority.

In its TRO, the FCC grandfathered all existing line-sharing arrangements and established a three-year transition period for new line-sharing arrangements. During the first-year, which began with the effective date of the order, the competitive LECs may obtain new line sharing customers at 25 percent of the state-approved recurring rates or the agreed upon recurring rates in existing interconnection agreements for stand-alone copper loops for those particular locations. (TRO, ¶ 265). During the second year, the recurring rate for those customers obtained during the first year after the release of the Order increases to 50 percent. *Id.* In the last year of the transition period, the recurring rate increases to 75 percent. *Id.* "After this third year, competitive LECs will not have

unbundled access to the HFPL, pursuant to section 251(c) (3), to provide those customers obtained after the Order became effective xDSL service over line shared loops. That is, after this third year, the recurring charge for the HFPL increases to 100% of the recurring charge for a stand-alone loop." *Id.* at FN 788.

Staff therefore recommends that line sharing arrangements continue to be ordered and billed at the rates contained in the parties' interconnection agreements in the interim. Additionally, given the industry-wide relevance of this issue, Staff recommends that this issue be addressed in the context of the generic Docket No. 19341-U.

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TAB 26

Louisiana Public Service Commission

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COMMISSIONERS

Irma Muse Dixon, Chairman
District III
C. Dale Sittig, Vice Chairman
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LAWRENCE C. ST. BLANC
Secretary

(MRS.) VON M. MEADOR
Deputy Undersecretary

EVE KAHAO GONZALEZ
General Counsel

September 10, 2004

2004 SEP 10 PM 4:23
LA PUBLIC SERVICE
COMMISSION

Ms. Terri Lefebvre
Louisiana Public Service Commission
Records and Recording Division
P.O. Box 91154
Baton Rouge, Louisiana 70821-9154

Re: Docket U-28027

Dear Ms. Lefebvre:

Attached hereto are an original and two copies of Staff's Brief to be filed in the above captioned docket. Please return me a date stamped copy.

With kindest personal regards, I remain,

Sincerely,

Brandon M. Frey
LPSC Staff Attorney

cc: Official Service List

BEFORE THE
LOUISIANA PUBLIC SERVICE COMMISSION

DIECA COMMUNICATIONS, INC. d/b/a COVAD COMMUNICATIONS COMPANY **DOCKET NO. U-28027**

EX PARTE

In re: Petition for Arbitration of Interconnection Agreement Amendment with BellSouth Telecommunications, Inc. Pursuant to Section 252(B) of the Telecommunications Act of 1996.

STAFF'S BRIEF CONCERNING THE 47 USC § 271 STATUS OF LINE SHARING

NOW COMES STAFF, of the Louisiana Public Service Commission ("LPSC", "Commission"), who hereby submits the following brief in support of its position relative to Dieca Communications, Inc. d/b/a Covad Communications Company's ("Covad") petition for arbitration, restricted to the single issue currently being addressed, namely, ""Is BellSouth Telecommunications, Inc. ("BellSouth") obligated to provide Covad access to line sharing after October 2004?"

BACKGROUND

Covad's petition for arbitration, wherein it requested the Commission issue a decision on a number of issues, was published in the Commission's Official Bulletin dated July 2, 2004. The threshold issue, as stated above, concerns whether BellSouth has a continuing obligation to provide access to line sharing after October 2004, pursuant to Section 271 of the

Telecommunications Act.[1] In light of this fast approaching determination deadline, which will be explained supra, the parties at the August 12, 2004 status conference held in this matter, established September 3, 2004 as a date to submit simultaneous briefs to the Administrative Hearings Division.[2]

The main parties to this proceeding, BellSouth and Covad, have provided a thorough discussion of the history of line sharing[3] in their respective briefs, a discussion which Staff will omit for the sake of brevity. Staff would like to emphasize the critical decision giving rise to this proceeding, the FCC's *Triennial Review Order*[4], wherein the FCC essentially determined that the high frequency portion of the loop ("HFPL") was no longer required to be unbundled pursuant to Section 251 of the Telecommunications Act of 1996. The critical date referenced herein, October 2004, is the date after which no new line sharing arrangements subject to the requirements of Section 251 may be requested.

APPLICABLE LAW

While there are numerous FCC and court decisions cited by the parties, as mentioned above, the threshold question to be answered is whether Section 271 of the Telecommunications Act of 1996 requires BellSouth to continue to provide "Line sharing." Section 271 provides, in pertinent part,

(B) Competitive checklist

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[1] 47 USC § 271.
[2] Staff originally agreed to submit a brief on this same date. Staff was subsequently advised that in all other jurisdictions in the BellSouth region, a different filing date was applied to the Staff response. Staff requested, and was granted, additional time to file.
[3] In simplistic terms, line sharing involves the sharing of the loop by two carriers, an ILEC providing voice service over the low frequency portion of the loop, in this instance BellSouth, and a CLEC providing data services (DLEC), providing broadband services over the high frequency portion of the loop.
[4] *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, et al.*, CC Docket No. 01-338, et al., Federal Communications Commission ("FCC") 03-36 (rel. Aug. 21, 2003.)

> Access or interconnection provided or generally offered by a Bell operating company to other telecommunications carriers meets the requirements of this subparagraph if such access and interconnection includes each of the following:
>
> ***
>
> (IV) Local loop transmission from the central office to the customer's premises unbundled from local switching or other services.

DISCUSSION

Initially, it should be noted that it is unmistakable that the FCC has determined that Incumbent Local Exchange Carriers ("ILECs") no longer have a Section 251 requirement to provide line sharing.[5] It is also unmistakable that the FCC recognized Regional Bell Operating Companies ("RBOCs") as having a continuing obligation to provide non-discriminatory access to network elements pursuant to § 271.[6] Unfortunately, the FCC did not address which network elements an RBOC has a continued 271 obligation to provide. Simply put, the *Triennial Review Order* makes no mention as to whether an RBOC has a continued obligation to provide line sharing pursuant to § 271. Thus, the central determination as to whether an obligation to provide line sharing under 271 exists may be couched on whether the definition of "Local loop transmission" includes line sharing. Unfortunately, while Congress provides no further explanation as to what composes local loop transmission, the pertinent FCC decisions provide some guidance.

1. **Effect of the FCC's *Triennial Review Order***

In the *Triennial Review Order* the FCC issued new rules concerning the status of unbundling. As this tribunal is no doubt aware, the DC Circuit's decision in *United States*

[5] TRO at ¶255-263.
[6] TRO at ¶ 650.

Telecommunication Ass'n v. FCC, 359 F.3rd 554 (D.C. Cir. 2004) ("USTA II") vacated a number of the FCC's findings. However, the portion of the decision wherein the FCC concluded that RBOCs are no longer required to continue making available as a UNE the High Frequency Portion of the Loop ("HFPL") for line sharing arrangements pursuant to Section 251 remained in affect. Nonetheless, as mentioned above, the FCC also concluded that,

> "BOCs have an independent obligation, under Section 271 (c)(2)(b) to provide access to certain network elements that are no longer subject to unbundling under Section 251, and to do so at just and reasonable rates."[7]

Thus, regardless of the FCC's position regarding the obligation to provide line sharing pursuant to § 251, it may still be the case that access is required to be provided pursuant to § 271.

2. Section 271 Orders

Section 271 of the Telecommunications Act of 1996 sets forth the process whereby an RBOC can seek entry into the long distance market. Central to the process is the RBOCs compliance with a number of factors contained in a detailed checklist of requirements established by the Act. While the above provides a very simplistic overview of § 271, it should be noted that the requirements of 271 essentially provide conditions which must be satisfied before the proverbial "carrot" was offered to RBOCs in the form of authority to provide long distance services. Among the requirements considered in the review process, specifically in Checklist Item 4[8], was the requirement that BellSouth provide non-discriminatory access to line sharing.

---

[7] TRO at ¶ 650.
[8] 47 USC 271(C)(2)(b)

While Staff is well aware the present issue concerns the obligations arising from Section 271 of the Federal Act, Staff would be remiss if it did not advise this tribunal that BellSouth submitted data relative to its provision of line sharing in Louisiana to be reviewed in connection with Checklist Item 4. Staff considered said information as part of its Final Recommendation issued in Docket U-22252-E, adopted by the LPSC in Order U-22252-E, which approved BellSouth's Louisiana 271 application at the state level.

The FCC, when jointly deciding BellSouth's Section 271 applications for Georgia and Louisiana, likewise considered line sharing in connection with Checklist Item 4, and approved BellSouth's performance by stating as follows:

> Our conclusion is based on our review of BellSouth's performance for all loop types, which include, as in past section 271 orders, voice grade loops, hot cut provisioning, xDSL capable loops, high capacity loops and digital loops, and our review of BellSouth's processes for line sharing and line splitting."[9]

While the FCC never definitively stated whether line sharing is a loop transmission facility as contemplated by Section 271(c)(2)(b), it is nonetheless clear that it found that BellSouth had at the time of its 271 application, an obligation to provide line sharing in connection with Checklist Item 4. Additionally, the FCC has made no pronouncement absolving BellSouth of a continuing obligation to comply with the requirements of Section 271, including, but not limited to, line sharing. Absent such a pronouncement, Staff must conclude the obligation continues to exist.

Certainly, it would be preferable if the FCC reached a definitive determination on § 271 status of line sharing. Indeed, two current proceedings pending before the FCC may

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[9] *Joint Application by BellSouth Corporation, BellSouth Telecommunication, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Georgia and Louisiana*, CC Docket No. 02-35, Released May 15, 2002, FCC 02-147.

reach a decision on this issue, including the *Order and Notice of Proposed Rulemaking in Docket 01-338*, released August 20, 2004, which seeks comment on, upon other things,

> (H)ow various incumbent LEC service offerings and obligations, such as tariffed offerings and BOC section 271 access obligations, fit into the Commission's unbundling framework. Id at ¶ 9.

Additionally, as mentioned by Covad, BellSouth has pending a Petition for Forbearance, filed pursuant to 47 USC 160(c), whereby it is seeking forbearance from its Section 271 obligations. However, in light of the impending change in the § 251 status of line sharing, the LPSC cannot wait for such a determination.

3. **BellSouth's Pending Motion to Modify SEEMS Plan in Docket U-22252-C 6-Month Review Proceeding.**

Staff would be remiss if it did not mention a Motion to Modify SEEMS Plan filed by BellSouth in Docket U-22252-C, which is currently the subject of an ongoing Staff review. Said motion is no different than similar motions filed by BellSouth throughout its region, and referenced in both BellSouth and Covad's filings in this matter. In no way is Staff's position, as stated herein, to be considered as determinative of that issue. Additionally Staff does not waive its right to fully address the motion in that proceeding.

CONCLUSION

Absent a definitive pronouncement from the FCC, Staff's position is that BellSouth has a continuing obligation to provide line sharing, in accordance with its grant of Section 271 authority.

Dated this 10th day of September 2004.

Respectfully submitted,
LPSC LEGAL DIVISION

Brandon Frey, (#24050)
Staff Attorney
Louisiana Public Service Commission
P.O. Box 91154
Baton Rouge, Louisiana 70821-9154

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing filing was mailed postage prepaid to all parties of record on 10th day of September, 2004.

Brandon Frey
Louisiana Public Service Commission

Service List
Docket No. - U-28027

All Commissioners
Brandon Frey - LPSC Staff Attorney
Arnold Chauviere - LPSC Utilities Division
Stan Perkins - LPSC Auditing Division

AA- Gordon D. Polozola, Kean, Miller, Hawthorne, D'Armond, McCowan and Jarman, One American Place, Suite 1700, P. O. Box 3513, Baton Rouge, LA 70821 P: (225) 387-0999 F: (225) 388-9133 Email: gordon.Polozola@keanmiller.com

I- Victoria K. McHenry, Carmen S. Ditta, 365 Canal Street, Suite 3060, New Orleans, LA 70130 P: (504) 528-2050 F: (504) 528-2948 Email: Victoria.mchenry@bellsouth.com on behalf of BellSouth Telecommunications Inc.

I- Janet S. Britton, Advanced Tel, Inc. d/b/a EATEL, 913 South Burnside Avenue, Gonzales, Louisiana 70737, P: (225) 621-4498.

BELLSOUTH APPENDIX

TAB 27

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FILED
SEP 10 2004
Clerk's Office
N.C. Utilities Commission

Docket No. P-775, Sub 8

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of

Petition of DIECA Communications, Inc., d/b/a Covad Communications Company for Arbitration of Interconnection Agreement Amendment with BellSouth Telecommunications, Inc., Pursuant to Section 252(b) of the Telecommunications Act of 1996	))))))	**PUBLIC STAFF COMMENTS ON LINE SHARING**

Clerk MH
AG
7 Comm.
T. Brown
Bennink
Long
Hoover
Sessoms
K-b
Kelly
Pastad
Wigfall

NOW COMES THE PUBLIC STAFF – North Carolina Utilities Commission, by and through its Executive Director, Robert P. Gruber, and submits these comments in response to the Commission's Order of August 13, 2004, concerning the obligation of BellSouth Telecommunications, Inc. (BellSouth) to provide line sharing to DIECA Communications, Inc., d/b/a Covad Communications Company (Covad).

1. In an August 12, 2004, joint letter to the Commission, BellSouth and Covad informed the Commission that the parties were seeking a Commission ruling on BellSouth's obligation to provide Covad access to line sharing after October 2004. The companies stated their intent to hold in abeyance all other issues and outstanding motions and to simultaneously file briefs supporting their respective positions on this limited matter.

2. The Commission's Order of August 13, 2004 granted the request of BellSouth and Covad to file legal briefs no later than September 3, 2004, with all other proceedings in this docket to be held in abeyance pending further order. In addition, the Commission requested the Public Staff to file comments on the briefs no later than September 10, 2004.

3. The single issue the parties have put before the Commission is whether BellSouth is obligated to provide Covad access to line sharing after October 2004. Line sharing is the process through which a competing local provider (CLP) accesses the high frequency portion of the loop (HFPL) while the incumbent local exchange carrier (ILEC) provides voice service over the lower frequency portion of the loop.

4. Two provisions of federal law, Sections 251 and 271 of the 1996 Act[1] are potentially pertinent to this question. Section 251 requires all ILECs such as BellSouth to interconnect with CLPs such as Covad and provide unbundled access to network elements in accordance with rules established by the Federal Communications

[1] References to "the Act" or "the 1996 Act" are to the Communications Act of 1934, as amended by the Telecommunications Act of 1996, 47 U.S.C. § 151 *et seq.*

Commission (FCC) when the CLPs would be impaired without such access. Section 271 provides a list of the requirements (the competitive checklist) that the former Bell Operating Companies (BOCs) including BellSouth must meet in order to provide in-region, InterLATA service Competitive checklist item 4 asks whether access or interconnection to the "local loop transmission from the central office to the customer's premises, unbundled from local switching or other services" is generally offered and makes no reference to impairment.

5. In its *Line Sharing Order,*[2] the FCC found that CLPs were impaired without access to the high frequency spectrum of a local loop as a network element. As a result, the FCC required ILECs to provide CLPs with unbundled access to the HFPL.

6. In its August 21, 2003 *Triennial Review Order* [3], the FCC concluded that CLPs were not impaired without access to the HFPL as a network element. Thus, the FCC found ILECs no longer had to provide line sharing to CLPs. Noting that line sharing was widespread, the FCC recognized the disruption to CLPs and end users alike that elimination of the line sharing requirement could create if the change were to take place on a flash-cut basis. Thus, the FCC's rules included provisions to gradually phase out line sharing as a Section 251 network element.

7. The FCC limited line sharing to mass market loops that are all copper or stand-alone copper. FCC Rule 51.319(a)(1)(i) includes both a grandfathering provision and a transition period. The grandfathering provision permits all line sharing arrangements existing as of the effective date of the *TRO* to remain available at the rates in effect prior to the effective date of the *TRO* so long as the CLP or its successor continues to provide xDSL service to the end user. The grandfathering provision remains in effect until the next biennial review.[4]

8. The transition period adopted by the FCC allows CLPs to continue to add new customers throughout the first year after the effective date of the *TRO*. The rate for accessing the HFPL during this first year will be 25% of the rate for stand-alone copper loops. The rate for the second year increases to 50% of the stand-alone copper loop while the third year rate increases to 75% of the stand-alone copper loop. After the third year, the ILEC is no longer required to provide line sharing to the CLP for end users initiating service on or after the effective date of the *TRO*.[5]

[2] *Deployment of Wireline Services Officering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket Nos. 98-147 and 96-98, Third Report and Order in CC Docket No. 98-147 and Fourth Report and Order in CC Docket No. 96-98, FCC 99-355 (released December 9, 1999).

[3] *Review of the Section 251 Unbundling Obligation of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36 (released August 21, 2003), *vacated in part and remanded, United States Telecom Ass'n v. FCC, 359 F.3d 554 (D.C. Cir 2004).*(*TRO*).

[4] *Id.*, Paragraph 264.

[5] *Id.*, Paragraph 265.

9. The continuing Section 251 obligation and the related requirements for ILECs to provide unbundled access to the HFPL through line sharing have been clearly spelled out by the FCC. There appears to be no disagreement between BellSouth and Covad with respect to the line sharing requirements of Section 251. The FCC, through its *TRO*, set out the rules and obligations for grandfathered line sharing customers as well as those line sharing customers in the transition phase. While *USTA II*[6] has vacated certain rules in the *TRO*, the changes to line sharing were unaffected.

10. The dispute between the parties concerns Covad's contention that BellSouth is obligated to make line sharing available to **new** customers of Covad on or after October 2, 2004, the first anniversary of the effective date of the *TRO*. This disagreement centers on whether line sharing is included in the unbundling and access to local loops requirement set forth in Section 271(c)(2)(B)(iv) of the Act. As noted by Covad, under the requirements BellSouth agreed to when it was granted in-region interLATA long distance authority under Section 271, BellSouth is required to provide access to unbundled local loops. This obligation is in addition to and independent of any obligations or requirements BellSouth might have under Section 251.

11. BellSouth argues that the local loop unbundling requirement addressed in Checklist Item 4 requires the provision of the whole loop, nothing more or nothing less. BellSouth argues that it is only required to provide line sharing under Section 251. And since the FCC has provided for a transition period to eliminate line sharing as a UNE, then the only obligation BellSouth has to provide line sharing arises from the requirements of the FCC's transition plan. Once the transition period ends, BellSouth maintains that it will no longer be required to provide line sharing to CLPs.

12. In the Kansas/Oklahoma Order[7] granting interLATA in-region authority for SBC Communications, Inc. (SBC) in Kansas and Oklahoma, the FCC concluded in Paragraph 178 that:

> In order to establish that it is "providing" unbundled local loops in compliance with checklist item 4, a BOC must demonstrate that it has a concrete and specific legal obligation to furnish loops and that it is currently doing so in the quantities that competitors demand and at an acceptable level of quality. A BOC must also demonstrate that it provides nondiscriminatory access to unbundled loops. **Specifically, the BOC must provide access to any functionality of the loop requested by a competing carrier unless it is not technically feasible to condition the loop facility to support the particular functionality requested.** In order to provide the requested loop functionality, such as the ability to deliver xDSL services, the BOC may be required to take affirmative steps to

[6] *U.S. Telecomm. Ass'n v. FCC*, 359 F. 3d 554 (D.C. Cir. 2004) *(USTA II)*

[7] *Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Docket No. 00-217, Memorandum Opinion and Order, FCC 01-29 (released January 22, 2001).

condition existing loop facilities to enable competing carriers to provide services not currently provided over the facilities. The BOC must provide competitors with access to unbundled loops regardless of whether the BOC uses digital loop carrier (DLC) technology or similar remote concentration devices for the particular loops sought by the competitor. (Footnotes deleted, Emphasis added)

13. The Kansas/Oklahoma Order clearly indicates that compliance with Checklist Item 4 requires BellSouth to do more than simply provide a whole loop to a CLP. This Order goes so far as to require the BOC to perform line conditioning if necessary. Indeed, this Commission noted the FCC's requirements as spelled out in the Kansas/Oklahoma Order in its Advisory Opinion with regard to BellSouth's request for 271 authority in North Carolina.[8]

14. BellSouth's contention that line sharing is not part of the Checklist Item 4 is inconsistent with its filings before this Commission and the FCC. Even though BellSouth now claims line sharing is not a requirement of Checklist Item 4, its brief and proposed order filed in Docket No. P-55, Sub 1022 addressed line sharing in connection with its compliance obligations of Checklist Item 4. In addition, BellSouth also addressed line sharing in its brief filed with the FCC in support of its Five-State Application for 271 authority.[9]

15. If providing line sharing was not required for ascertaining compliance with Checklist Item 4, BellSouth presumably would not have included an analysis of its line sharing capability. Further, the Public Staff submits the FCC would not have included sections dealing with line sharing when discussing Checklist Item 4 compliance in its numerous 271 Orders, including the Order that authorized BellSouth to provide in-region, InterLATA long distance service in North Carolina.[10]

16. The Public Staff urges the Commission to find that line sharing is a part of the Checklist Item 4 obligations of BellSouth. The Commission's determination of this issue should reflect that BellSouth has a Section 251 obligation to provide line sharing to existing customers on a grandfathered and transitional basis as well as an on-going Section 271 obligation to make line sharing available to new customers of CLPs on and after October 2, 2004.

[8] *Application of BellSouth Telecommunications, Inc., to Provide In-Region, InterLATA Service Pursuant to Section 271 of the Telecommunications Act of 1996*, Docket No. P-55, Sub 1022, Order and Advisory Opinion Regarding Section 271 Requirements. Page 168 (Issued July 9, 2002).

[9] *Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina*, WC Docket No. 02-150, Brief in Support of Application by BellSouth for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina (filed June 20, 2002).

[10] *Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina and South Carolina*, WC Docket No. 02-150, Memorandum Opinion and Order, FCC 02-260, Paragraphs 249-50 (Released September 18, 2002).

17. The issue put forth by BellSouth and Covad does not require a Commission determination of the appropriate rates for line sharing. The Public Staff notes that the FCC has set forth specific rates for line sharing provided under the provisions of Section 251. With respect to the appropriate rates for line sharing provided under the auspices of Section 271, the Public Staff believes the FCC's Section 201 and 202 standards for just and reasonable rates would apply.

18. The Public Staff notes that several proceedings are ongoing at the federal level concerning line sharing which may ultimately have an impact on this matter.

Respectfully submitted this the 10th day of September 2004.

PUBLIC STAFF
Robert P. Gruber
Executive Director

Antoinette R. Wike
Chief Counsel

Robert B. Cauthen, III
Lucy E. Edmondson
Staff Attorneys

4326 Mail Service Center
Raleigh, North Carolina 27699-4326
Telephone: (919) 733-6110

CERTIFICATE OF SERVICE

I certify that a copy of these Comments has been served on all parties of record or their attorneys, or both, by depositing a copy in the United States Mail, first class postage prepaid, properly addressed.

This the 10th day of September 2004.

Robert B. Cauthen, Jr.

BELLSOUTH APPENDIX

TAB 28

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Implementation of requirements arising from Federal Communications Commission triennial UNE review: Local Circuit Switching for Mass Market Customers.	))))	Docket No. 030851-TP

DIRECT TESTIMONY OF

MARK DAVID VAN DE WATER

ON BEHALF OF
AT&T COMMUNICATIONS OF THE SOUTHERN STATES, LLC

DECEMBER 4, 2003

failure and when the customer can be migrated to an unbundled loop. The rolling interval for affected loops/customers should restart.

ECONOMIC

- The batch process design must result in significant cost reduction for all involved parties.

VALIDATION, TESTING AND QUALITY ASSURANCE

- ILECs must prove they have systemic capability to handle the provisioning of hot cuts at volumes anticipated across all its markets in the absence of unbundled local switching. Therefore, once designed, the batch cut process must be subject to both pre-implementation and post implementation testing. Pre-implementation testing should include third party "time and motion" study of the hot cut process, and third party-monitored ILEC testing using its own collocation and migration of significant numbers of its own customers through hot cuts from direct connection to its switch to its collocation equipment installed to operate as a pseudo-CLEC specifically for this test. Post-implementation "testing" would include on-going commission review to determine if the batch hot cut process meets the needs of commercial mass markets in a manner that permits effective and efficient competition.

- The Commission must direct the ILEC to investigate, report and eliminate any negative impacts of large scale migration from UNE-P to UNE-L from the following:

    - E-911 "unlocks"
    - Number porting
    - Availability of repair testing capabilities
    - Repair databases
    - Billing system migrations, such as from Carrier Access Billing System ("CABS") to Customer Record Information System ("CRIS")
    - Provisioning systems such as Trunks Integrated Records Keeping System ("TIRKS")
    - Directory listing and assistance

- The Commission must direct the ILEC to investigate, report and eliminate any negative impact of large-scale migration from UNE-P to UNE-L on local network interconnection trunking and tandem performance.

- The Commission must direct the ILEC to report at a central office level the current number of working IDLC access lines and the spare parallel copper or UDLC facilities available to migrate these lines to, should the customer wish to change their local service provider. It should also provide its plans to provide an unbundled loop when spare parallel copper or UDLC facilities are not available.

BELLSOUTH APPENDIX

TAB 29

LAW OFFICES
Messer, Caparello & Self
A Professional Association

Post Office Box 1876
Tallahassee, Florida 32302-1876
Internet: www.lawfla.com

85

October 30, 2003

BY HAND DELIVERY
Ms. Blanca Bayó, Director
Division of Records and Reporting
Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Docket No. 030851-TP

Dear Ms. Bayó:

Enclosed for filing on behalf of MCImetro Access Transmission Services, LLC and MCI WorldCom Communications, Inc. are an original and one copy of MCI's Notice of Serving Responses and Objections to BellSouth Telecommunications, Inc.'s First Set of Interrogatories and First Request for Production of Documents in the above referenced dockets.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

Thank you for your assistance with this filing.

Sincerely yours,

Floyd R. Self

FRS/amb
Enclosures
cc: Parties of Record

RECEIVED
OCT 31 2003
DIRECTOR-REG. RELATIONS
TALLAHASSEE, FL

DOWNTOWN OFFICE, 215 South Monroe Street, Suite 701 • Tallahassee, Fl 32301 • Phone (850) 222-0720 • Fax (850) 224-4359
NORTHEAST OFFICE, 3116 Capital Circle, NE, Suite 5 • Tallahassee, Fl 32308 • Phone (850) 668-5246 • Fax (850) 668-5613

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 56. If MCI has a preferred process for bulk hot cuts that differs from BellSouth's process, identify each specific step in MCI's process that differs from BellSouth's process.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing bulk hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and this process will, in part, be dependent upon discovery responses developed in this proceeding and in others throughout the country that are now underway. However, any such bulk hot cut processes need to be developed through the input of each of the carriers, and it is critical that the resulting hot cut process must be provided by each ILEC on a nondiscriminatory basis.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 57. Does MCI have any estimates of what a typical individual hot cut should cost? If the answer to this Interrogatory is in the affirmative, please provide that estimate, describe with particularity how that estimate was calculated, and identify all documents referring or relating to such estimates.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing individual hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and this process will, in part, be dependent upon discovery responses developed in this proceeding and in others throughout the country that are now underway. However, any such individual hot cut processes need to be developed through the input of each of the carriers, and it is critical that the resulting hot cut process must be provided by each ILEC on a nondiscriminatory basis.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 58. Does MCI have any estimates of what a typical bulk hot cut should cost? If the answer to this Interrogatory is in the affirmative, please provide that

estimate, describe with particularity how that estimate was calculated, and identify all documents referring or relating to such estimates.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing bulk hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and this process will, in part, be dependent upon discovery responses developed in this proceeding and in others throughout the country that are now underway. However, any such bulk hot cut processes need to be developed through the input of each of the carriers, and it is critical that the resulting hot cut process must be provided by each ILEC on a nondiscriminatory basis.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 59. What is the largest number of individual hot cuts that MCI has requested in any individual central office in each of the nine BellSouth states on a single day? In answering this Interrogatory, identify the central office for which the request was made, and the number of hot cuts that were requested. State with specificity what the outcome was for each of the hot cuts in each of the central offices so described, if not provided in response to an earlier interrogatory.

MCI RESPONSE: MCI adopts and incorporates its General Objections 2, 7, 8, 9, and 10, and its Specific Objection 18 as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: MCI has not ordered any hot cuts on a commercial basis for residential customers.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 60. Does any ILEC in the BellSouth region have a batch hot cut process that is acceptable to MCI or that MCI believes is superior to BellSouth's batch hot cut process? If so, identify the ILEC and describe with particularity the ILEC's batch hot cut process, specifying any differences between the ILEC's batch hot cut process and BellSouth's.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 8, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing batch hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and

INTERROGATORY 65. Does any ILEC outside the BellSouth region have a rate for a batch hot cut process that is acceptable to MCI? If so, name the ILEC and provide the rate and the source of the rate.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 8, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing batch hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and this process will, in part, be dependent upon discovery responses developed in this proceeding and in others throughout the country that are now underway. However, any such batch hot cut processes need to be developed through the input of each of the carriers, and it is critical that the resulting hot cut process must be provided by each ILEC on a nondiscriminatory basis.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 66. Does any ILEC outside the BellSouth region have an individual hot cut process that is acceptable to MCI or that MCI believes is superior to BellSouth's individual hot cut process? If so, identify the ILEC and describe with particularity the ILEC's individual hot cut process, specifying any differences between the ILEC's individual hot cut process and BellSouth's.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing individual hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and this process will, in part, be dependent upon discovery responses developed in this proceeding and in others throughout the country that are now underway. However, any such individual hot cut processes need to be developed through the input of each of the carriers, and it is critical that the resulting hot cut process must be provided by each ILEC on a nondiscriminatory basis.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 67. Does any ILEC outside the BellSouth region have a rate for an individual hot cut process that is acceptable to MCI? If so, name the ILEC and provide the rate and the source of the rate.

MCI RESPONSE: MCI adopts and incorporates its General Objections 3, 11, 12, and 14, and its Specific Objection 21, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: At this time, MCI does not have a preferred process for performing individual hot cuts since MCI is not presently fully apprised of all such hot cut processes available from BellSouth and other carriers throughout the state, region, and country. MCI is currently in the process of identifying and developing this kind of information for analysis, and this process will, in part, be dependent upon discovery responses developed in this proceeding and in others throughout the country that are now underway. However, any such individual hot cut processes need to be developed through the input of each of the carriers, and it is critical that the resulting hot cut process must be provided by each ILEC on a nondiscriminatory basis.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 68. Does MCI order coordinated or non-coordinated hot cuts?

MCI RESPONSE: MCI adopts and incorporates its General Objections 2, 7, 8, 9, and 10, and its Specific Objection 18, as if set forth herein verbatim. MCI has not ordered any hot cuts on a commercial basis for residential customers.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 69. Does MCI use the CFA database?

MCI RESPONSE: MCI adopts and incorporates its General Objection 9, and its Specific Objection 16, as if set forth herein verbatim. Subject to, and without waiving these objections, MCI states as follows: MCI will provide to BellSouth certain confidential information pursuant to the protective agreement between the parties in the attached confidential document identified as MCI - 000072 to MCI - 000073.

Response provided by: Objections provided by Counsel. Substantive response provided by Greg Darnell. MCI WorldCom Communications, Inc., 6 Concourse Parkway, Suite 3200, Atlanta, Georgia 30328

INTERROGATORY 70. Identify every issue related to BellSouth's hot cut process raised by MCI at the Florida CLEC collaborative since October 2001.

645D

LAW OFFICES
Messer, Caparello & Self
A Professional Association

Post Office Box 1876
Tallahassee, Florida 32302-1876
Internet: www.lawfla.com

February 6, 2004

BY HAND DELIVERY
Ms. Blanca Bayó, Director
Commission Clerk and Administrative Services
Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Docket No. 030851-TP

Dear Ms. Bayó:

Enclosed for filing on behalf of MCImetro Access Transmission Services, LLC and MCI WorldCom Communications, Inc. are an original and one copy of MCI's Notice of Serving Objections and Responses to BellSouth's Fifth Set of Interrogatories (Nos. 188-211) and Fifth Request for Production of Documents (Nos. 30-31) in the above referenced docket.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

Thank you for your assistance with this filing.

Sincerely yours,

Floyd R. Self

FRS/amb
Enclosures
cc: Parties of Record

HAND DELIVERY
DATE 2/6/4
TIME 4:35pm

DOWNTOWN OFFICE, 215 South Monroe Street, Suite 701 • Tallahassee, Fl 32301 • Phone (850) 222-0720 • Fax (850) 224-4359
NORTHEAST OFFICE, 3116 Capital Circle, NE, Suite 5 • Tallahassee, Fl 32308 • Phone (850) 668-5246 • Fax (850) 668-5613

206. State all facts and identify all documents relating or referring to any evidence that shows that "work is required on all of BellSouth's database used to configure and provide UNE-L to mass market customers, including LFACS, E-911, LIDB, CNAM, DA/DL and potentially others."

MCI RESPONSE: MCI adopts and incorporates General Objections 1, 2, 3, and 4, and Specific Objection 5. Subject to and without waiving these objections, MCI states: MCI has issued no orders for UNE-L in FL so does not have direct information on this question.

Response provided by: Objections provided by Counsel. Substantive response provided by Sherry Lichtenberg, Senior Manager, Operational Support Systems Interfaces and Facilities Development, MCI, 1133 19th Street, NW, Washington, DC 20036-3604.

207. Identify every instance by date and circuit number in which MCI's Florida customers allegedly have been "put in the middle of 'finger pointing' exercises," involving BellSouth and MCI, with respect to the provisioning of UNE-L service, as discussed in the Direct Testimony of Sherry Lichtenberg at pages 34-35.

MCI RESPONSE: MCI adopts and incorporates General Objections 1, 2, 3, and 4, and Specific Objection 5. Subject to and without waiving these objections, MCI states: MCI has not issued UNE-L orders in FL. The statement in the testimony is "could" put customers in the middle of finger pointing exercises.

Response provided by: Objections provided by Counsel. Substantive response provided by Sherry Lichtenberg, Senior Manager, Operational Support Systems Interfaces and Facilities Development, MCI, 1133 19th Street, NW, Washington, DC 20036-3604.

208. Provide all evidence upon which MCI bases its contention that the timeliness of BellSouth's 911 process should be revised as discussed by Sherry Lichtenberg on page 39 of her Direct Testimony.

MCI RESPONSE: MCI adopts and incorporates General Objections 1, 2, 3, and 4, and Specific Objection 5. Subject to and without waiving these objections, MCI states: MCI has not issued orders for residential UNE-L orders in Florida so has no experience with this process. MCI based its opinion on the fact that current UNE-L order volumes are low and that higher volumes could have an impact on the 911 system.

Response provided by: Objections provided by Counsel. Substantive response provided by Sherry Lichtenberg, Senior Manager, Operational Support Systems Interfaces and Facilities Development,

CO on a single day.

- Provide an on-line tracking tool similar to the existing Verizon WPTS tool and the tools proposed by SBC and Qwest that will allow CLECs to have near real-time information on batch migration status on a per order basis.
- Initiate the LNP trigger at the end of the hot cut.
- Include line split and line shared lines in the transition batch hot cut process to allow the transition of these lines from UNE-P or retail without taking down the customer's data services.
- Explain the BST process for selecting one of the 8 unbundling methods cited in the testimony of Ken Ainsworth.
- Provide a new CLEC electronic notifier that informs CLECs of the unbundling method used to migrate a customer from UNE-P to UNE-L.
- Allow CLECs to "reserve" a spare copper facility that can be used to migrate a customer from an IDLC UNE-P line to UNE-L. The reservation system would be similar to that offered for reserving telephone numbers.

Response provided by: Objections provided by Counsel. Substantive response provided by Sherry Lichtenberg, Senior Manager, Operational Support Systems Interfaces and Facilities Development, MCI, 1133 19th Street, NW, Washington, DC 20036-3604.

211. Provide by date, telephone number, or circuit identification every occurrence that support Ms. Lichtenberg's Direct Testimony at pages 49-50 that BellSouth's hot cut "process is not working" in Florida.

MCI RESPONSE: MCI adopts and incorporates General Objections 1, 2, 3, and 4, and Specific Objection 5. Subject to and without waiving these objections, MCI states: MCI has not submitted UNE-L orders in Florida for mass market customers at this time.

Response provided by: Objections provided by Counsel. Substantive response provided by Sherry Lichtenberg, Senior Manager, Operational Support Systems Interfaces and Facilities Development, MCI, 1133 19th Street, NW, Washington, DC 20036-3604.

MCI's RESPONSES TO BELLSOUTH'S FIFTH REQUEST FOR PRODUCTION

30. Produce all documents identified in response to BellSouth's Fifth Set of Interrogatories.

MCI RESPONSE: MCI adopts and incorporates General Objections 1, 2, 3, and 4, and Specific Objection 5. Subject to and without waiving these objections, MCI states: All documents responsive to this production request have been produced in response to these interrogatories. See answers to Interrogatories 188-211, above.

BELLSOUTH APPENDIX

TAB 30

REQUEST:	BellSouth Seventh Set of Interrogatories
DATED:	January 21, 2004
Interrogatory 272:	State all facts and identify all documents that support Ms. Brenner's testimony that "over half of orders were cancelled prior to conversion" in paragraph 40 of her FCC Declaration referenced on page 9 of Jay Bradbury's Rebuttal Testimony. In answering this Interrogatory, describe with particularity AT&T's experiences with cancelled orders in BellSouth's region and quantify the number of such cancelled orders.
Response:	See response to Interrogatory No.266. BellSouth specific data is no longer available. However, if AT&T had not experienced the same operational and economic problems in BellSouth as it did nationally, AT&T would have continued using a UNE-L strategy in BellSouth.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Implementation of requirements arising from Federal Communications Commission triennial UNE review: Local Circuit Switching for Mass Market Customers.	)))))	Docket No. 030851-TP Filed: February 18, 2004

AT&T'S SUPPLEMENTAL RESPONSES TO BELLSOUTH'S SEVENTH SET OF INTERROGATORIES

Subject to the General Objections filed with the Florida Public Service Commission on or about January 28, 2004, AT&T Communications of the Southern States, LLC and TCG South Florida (hereinafter "AT&T"), pursuant to the *Order Establishing Procedure*, Order No. PSC-03-1054-PCO-TP, issued September 22, 2003 (hereinafter "*Procedural Order*"), Rule 28-106.206 of the Florida Administrative Code, and Rules 1.280 and 1.340 of the Florida Rules of Civil Procedure, submits the following Supplemental Responses to BellSouth Telecommunications, Inc.'s (hereinafter "BellSouth") Seventh Set of Interrogatories to AT&T Communication of the Southern States, LLC, served on January 21, 2004, as follows:

REQUEST: BellSouth Seventh Set of Interrogatories

DATED: January 21, 2004

Interrogatory 266: State all facts and identify all documents that support Ms. Brenner's testimony that "coordinated hot cuts cause significant delays in provisioning service" in paragraph 7 of her FCC Declaration referenced on page 9 of Jay Bradbury's Rebuttal Testimony. In answering this Interrogatory, describe with particularity AT&T's experiences with coordinated hot cuts in BellSouth's region and quantify the "delays" allegedly experienced by AT&T in connection with those hot cuts.

Response: This interrogatory seeks information pertaining to AT&T's experience in providing local service using UNE-L, particularly with regard to the hot cut process, on both a national and BellSouth regional level. As the Vice President, AT&T Business Local Services, Ms. Brenner was in charge of the development, testing, introduction, delivery and management of the portfolio of local services offered in the period of time that AT&T pursued a local entry strategy using UNE-L, all as described in her Declaration. Ms. Brenner's FCC Declaration summarized that experience and was based upon the collective information assembled within the Business Local Services organization as a part of pursuing and implementing that business plan. The type of data Ms. Brenner relied upon was provided to her in meetings and briefings as 'report card' or 'dashboard' documents that were dynamic (i.e., information changed routinely and it was not necessary to maintain the many versions of the documents) . Since the time of Ms. Brenner's Declaration, those tools/data keeping has changed and current versions (or even the last version) of those documents do not exist. Thus, no documents exist outside of Ms. Brenner's Declaration.Similarly, Denise Berger was District Manager for Supplier Performance with responsibility for pursuing and implementing the UNE-L local service entry strategy in the Southern region, including managing the ongoing performance improvement of AT&T's local services suppliers in the Southern Region.. Ms. Berger's testimony filed in the North Carolina 271 case, produced in response to Interrogatory No. 125 summarized that experience in the BellSouth region and was based upon the collective information assembled within the regional local organization as a part of pursuing and implementing that

business plan. To the extent this Interrogatory requests "quantification" of a shortcoming of BellSouth's hot cut provisioning process, Ms. Berger's testimony addresses that point.-

BELLSOUTH APPENDIX

TAB 31

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 030851-TP

In the Matter of

IMPLEMENTATION OF REQUIREMENTS ARISING FROM FEDERAL COMMUNICATIONS COMMISSION'S TRIENNIAL UNE REVIEW: LOCAL CIRCUIT SWITCHING FOR MASS MARKET CUSTOMERS.

_____/

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VOLUME 27

Pages 3875 through 3971

PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN BRAULIO L. BAEZ COMMISSIONER J. TERRY DEASON COMMISSIONER LILA A. JABER COMMISSIONER RUDOLPH "RUDY" BRADLEY COMMISSIONER CHARLES M. DAVIDSON
DATE:	Friday, February 27, 2004
TIME:	Commenced at 9:00 a.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida

FLORIDA PUBLIC SERVICE COMMISSION

minimum number of customers that CLECs have to serve in a market before that market can have a no impairment finding?

A No.

Q If that's not what that principle means, just say no and that'll be it.

A No. They should not fix a set amount in this proceeding. These are principles that you apply to the facts on the ground in Florida.

Q Got it.

All right. Let's talk about really a derivation of your criteria number 1.

The self-provisioning trigger candidate switches must not be enterprise switches. If I understand correctly, your position is that a switch that serves both enterprise and mass market customers cannot be considered a switch for the purpose of determining whether a CLEC that owns it is a self-provisioning candidate or not or trigger candidate or not unless at least 20 percent of the capacity of that switch is used to provide mass market service; is that correct?

A Yes. Again, it's not a hard and fast percentage. But we know that the FCC looked out at switches in the 80 to 90 percent -- it's easier at least for me to think of this in terms of its digital capacity, its enterprise capacity. They looked out at switches that had 80 to 90 percent of their capacity being used to provide service to enterprise customers

and viewed those as enterprise switches.

Now would 75 percent/25 percent mean it was mass market? I don't know. You know, we can apply these principles to the facts on the ground here in Florida. It's pretty straightforward. I think the examples we have and the carriers you have to look at are pretty clear. As you get nearer the boundary layer of, you know, 80 percent, then you might need to take a more nuanced look at the carrier. So what you're really trying to figure out is, hey, is this carrier and its activity really the type of thing that shows me there's no barriers in this market? And, you know, is there a magic percentage there? You're not going to get one from me today. But we don't need one because the carriers that are here in Florida are very comfortably inside the range used by the FCC to characterize enterprise switches.

Q Well, let's talk about that a little bit. Let's take it piece by piece.

Let me, let me have Page 159 of his deposition, would you, please, and Page 160.

In your deposition --

A Excuse me, Mr. Lackey. Let me get to Page -- Page 159?

Q It starts on 159 and goes to 160. And you and I were talking -- are you there?

A I don't --

Q Do you have it?

A If I could stop you one moment.

Q Sure.

A The copy of the deposition I have -- all right. Now I see where the page -- the page numbers don't match up with the pages. All right.

Q We've got it on the screen, if you need it. I just want to make sure that we're still where we were, and that was -- unless I misunderstood you, you said that, for instance, if a switch was only at 79 percent capacity, you'd still argue that you couldn't count it. Did I misunderstand that?

A Yes. Although I think in the deposition I might have said could instead of would, because the point I was trying to convey to you was this is not a hard limit. It is, it is an area of -- you know, it's a measure that the FCC used.

Q Well, I'm going to talk about that, but I want to make sure that you and I are agreed about what your position is before I go to the FCC.

If I have a switch that's got a capacity of 50,000 voice grade equivalent lines and I'm serving 5,000 single line residences out of that switch and the other 45,000 voice grade equivalent lines are being used for enterprise customers, your position is that the, assuming all the other test criteria were made, that the CLEC that owned that switch couldn't be counted as a trigger candidate in that market; correct?

A They shouldn't be, because that would be an enterprise switch.

Q And if --

A Now I just want to point out to you -- I mean, the hypothetical I'm sure you did just from math, but we're not talking about line count levels where we have somebody who's out there with 5,000 customers and I'm recommending you not count him because they have this other capacity of 45,000 lines. I mean, we're talking about companies that have 100 lines of residential, of analog service or maybe 1,500 or maybe, you know, 1,000. We're talking about low levels of activity, not that they're out there with some very large market presence, but they have large market presence in both markets.

Q Well, once again, I'm just trying to establish the principle that we can apply on a going-forward basis. And so if there were 10,999 residential customers being served off that same switch, that 50,000 line capacity switch, and the other, whatever 10,999 from 50,000 is, were used to serve residential customers, according to your testimony in the deposition anyway you wouldn't count the CLEC that owned that switch as a trigger candidate in that market; correct?

COMMISSIONER BRADLEY: Mr. Chair, I need the gentleman who is testifying to speak into the mike, please.

MR. LACKEY: I'm sorry, Commissioner. Is it me that

you need to be at the mike? Can you not hear me?

CHAIRMAN BAEZ: Commissioner Bradley, is it the questions that you can't hear or the answers?

COMMISSIONER BRADLEY: It's the answers.

CHAIRMAN BAEZ: Okay.

WITNESS GILLAN: I apologize, Commissioner Bradley.

CHAIRMAN BAEZ: Is that better?

COMMISSIONER BRADLEY: Yes.

WITNESS GILLAN: I feel like I'm going to start sounding like Charlton Heston.

BY MR. LACKEY:

Q Would you like me to repeat the question?

A No, Mr. Lackey. I understand the question.

Q Okay.

A Let me try and answer it this way.

MR. LACKEY: I'd like -- Mr. Chairman, I think it was a yes or no question again. I'd like a yes or no --

COMMISSIONER BRADLEY: Now I need the gentleman who's asking the questions to speak into the microphone.

CHAIRMAN BAEZ: Mr. Lackey, I think it was you all along. Can you ask Mr. Gillan -- for my benefit, can you ask the question again?

MR. LACKEY: I will. And I'll try to stay very close to the microphone.

CHAIRMAN BAEZ: Yes.

BY MR. LACKEY:

Q The same switch I was talking about a moment ago, the switch is serving -- let's just make it easy. 10,000 are residential single line customers. The other 40,000 lines are being used to serve enterprise customers. 20 percent of the capacity is being used to serve mass market customers. I understood your position, you would still argue that this Commission could not count the CLEC that owned that switch, assuming all the other criteria were met, as a trigger candidate. Is that your position?

A Yes. I think you could still argue that. Now how compelling that argument would be under that fact situation to this Commission, I don't know. As a practical matter, what my testimony is to the Commission is that you have the judgment -- and when you look at the carriers here who have all provided you affidavits that clearly tell you that we're in the enterprise business and we pick up analog lines because of either something we did in the past we don't do anymore or we've picked them up because to serve enterprise customers you pick up some analog lines. The FCC, when it applied its judgment, it looked at these types of percentages and said these carriers are still enterprise. And I'm recommending to you that when you look at these facts, you conclude that these carriers are still enterprise and you not count them in the trigger analysis.

Now at some other point in the future and somebody shows up here with 10,000 residential lines on that switch, would you still reach that same fact-finding for that carrier? I don't know. That's -- but you have the judgment and the responsibility and the authority to look at it.

COMMISSIONER JABER: Mr. Chairman, may I interject a quick question?

CHAIRMAN BAEZ: Go ahead, Commissioner.

COMMISSIONER JABER: Just to try to move us along.

Mr. Gillan, I think you can argue anything in life, and certainly as an attorney I always like to give it a good try.

Let me, let me ask the same question a different way. Regardless of what you can or cannot argue, do you believe the Commission can exercise its discretion and find enough evidence in the record to support that if 20 percent of the lines that are served are mass market, then it is sufficient to make a finding that the geographic market is predominantly mass market; therefore, switching comes off the UNE list? I'm not asking for your argument. I'm asking for you to confirm that we can exercise our discretion to say that there's sufficient evidence in the record based on the percentage 20 percent. And, again, not passing judgment on whether we will or we won't, but --

WITNESS GILLAN: No, Commissioner. In fact, the

answer to your question is I think possibly in some fact situation, and that was precisely my point, I think the Commission -- I think when the percentages are up, up in the 90s, when you look at switches that are 90 percent digital or enterprise, that it would be very, very unlikely that you could legitimately consider those switches to be mass market. Obviously you get down in the 50/50, you're going to be able to, I think, find that switches that have that kind of mix are certainly mass -- are likely to be mass market.

My point was is that there's clearly a gray area in here that the Commission can exercise its own judgment. I can't tell you today a hard and fast percentage that you should apply without, without having better information about the type of carrier.

COMMISSIONER JABER: Okay. Then, then let's dig deep on what those fact scenarios should be that I should evaluate. What -- let's set aside the percentages for a moment. What are the fact distinctions I should be looking at then?

WITNESS GILLAN: I think the first fact distinction is you look at the carrier and you ask what is it that it's -- what business is it principally in? When its sales force goes out into the market, what is the, what are the things in its product portfolio that it's really interested in selling? And the fact situation here for, for most of the carriers that this criteria is used to disqualify is those carriers go out into

the marketplace selling DS1-based services that mix voice and data.

COMMISSIONER JABER: Okay. So the first one would be what is the product portfolio for each carrier? What's the second one? I want you to quickly go through these so we can cut to the chase. What other fact scenarios should we look at?

WITNESS GILLAN: I would look at the type of line additions it's making recently. I would look at what has it done, for instance, in the past six months or a year. If in, for instance, Mr. Lackey's 10,000-line hypothetical, if all those 10,000 lines were added recently, then that shows or would tend to cause you to conclude that this is a company that has entered the mass market and the percentages just haven't completely caught up.

On the other hand, if those lines had been added five years ago or four years ago or whatever and they used to be 50,000 lines and now they're 10, that tells you a completely different story. So I'd look at what they're selling today and I'd look at the pattern of their volume over a period of time, if, if needed. As a practical matter, Commissioner --

COMMISSIONER JABER: Mr. Gillan, what else? What else?

WITNESS GILLAN: Those are the only two I can think of off the top of my head, Commissioner. Because on the affidavits that you have in this record for these carriers,

it's not a judgment call. They tell you directly; we are servicing the enterprise market, and the analog lines we have are either the product of something we did and abandoned (phonetic) or we have, or we pick up as an incidental part of servicing the analog or the enterprise marketplace.

COMMISSIONER JABER: Okay. So it's your testimony that to break down the analysis even further we should look at what carriers are in that market and what they are principally providing in terms of product portfolio and what line additions they've made recently, whether they're analog or digital, and/or digital.

Now do you believe that we have the evidence in this record to make that kind of determination?

WITNESS GILLAN: Yes.

COMMISSIONER JABER: Okay. Thank you.

CHAIRMAN BAEZ: Go ahead, Mr. Lackey.

BY MR. LACKEY:

Q The geographic area that you recommend in your testimony on behalf of the FCCA is the LATA; is that correct?

A Yes.

Q And you make the point, I believe, on Page 8 of your rebuttal testimony that limiting that area or taking that area to a smaller area ignores the primary defining characteristic of the mass market as a broadly dispersed customer set; is that correct?

BELLSOUTH APPENDIX

TAB 32

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)	CC Docket No. 01-338
	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
	)	
Deployment of Wireline Services Offering Advanced Telecommunications Capability	)	CC Docket No. 98-147
	)	

Reply Declaration

By

National Economic Research Associates, Inc.

On Behalf of

BellSouth Corporation

July 17, 2002

I. INTRODUCTION

A. Statement of Qualifications

Dr. William E. Taylor

1. My name is William E. Taylor. I am Senior Vice President of National Economic Research Associates, Inc. ("NERA"), head of its Communications Practice, and head of its Cambridge office located at One Main Street, Cambridge, Massachusetts 02142.

2. I have been an economist for over twenty-five years. I earned a Bachelor of Arts degree from Harvard College in 1968, a Master of Arts degree in Statistics from the University of California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974, specializing in Industrial Organization and Econometrics. For the past twenty-five years, I have taught and published research in the areas of microeconomics, theoretical and applied econometrics, which is the study of statistical methods applied to economic data, and telecommunications policy at academic and research institutions. Specifically, I have taught at the Economics Departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology. I have also conducted research at Bell Laboratories and Bell Communications Research, Inc. I have participated in telecommunications regulatory proceedings before several state public service commissions.

3. I have also filed testimony before the Federal Communications Commission and the Canadian Radio-television Telecommunications Commission on matters concerning incentive regulation, price cap regulation, productivity, access charges, local competition, interLATA competition, interconnection and pricing for economic efficiency. Recently, I was chosen by the Mexican Federal Telecommunications Commission and Telefonos de Mexico ("Telmex") to arbitrate the renewal of the Telmex price cap plan in Mexico.

4. I have also testified on market power and antitrust issues in federal court. In recent work years, I have studied—and testified on—the competitive effects of mergers among major telecommunications firms and of vertical integration and interconnection of telecommunications networks. Finally, I have appeared as a telecommunications commentator on PBS Radio and on The News Hour with Jim Lehrer.

Dr. Aniruddha Banerjee

5. My name is Aniruddha Banerjee. I am a Vice President with the Communications Practice at NERA.

6. I earned a Bachelor of Arts (with Honors) and a Master of Arts degree in Economics from the University of Delhi, India, in 1975 and 1977, respectively. I received a Ph.D. in Agricultural Economics from the Pennsylvania State University in 1985, and served there subsequently as an Assistant Professor of Economics. I have over eight years of experience teaching undergraduate and graduate courses in various fields of economics and econometrics, and have conducted academic research that has led to publications and conference presentations.

7. Since 1988, I have held various positions in the telecommunications industry. Prior to my present position, I have been an economist in the Market Analysis & Forecasting Division at AT&T Communications, Inc., a Member of Technical Staff at Bell Communications Research (n/k/a Telcordia Technologies), and a Research Economist at BellSouth Telecommunications, Inc. In my present capacity, I have filed expert testimony before the Federal Communications Commission on depreciation requirements of incumbent local exchange carriers, BellSouth's entry into interLATA long distance market in Louisiana, and efficient inter-carrier compensation for Internet-bound traffic. I have also testified before state regulatory commissions on cost models for unbundled network element pricing, interconnection arrangements and imputation analysis, universal service, reciprocal compensation for Internet-bound traffic, and demand analysis for intraLATA long distance service.

8. I have published articles on telecommunications and finance in academic and industry journals and presented research findings periodically at industry and academic conferences.

Mr. Charles J. Zarkadas

9. My name is Charles J. Zarkadas. I am a Vice President with the Communications Practice at NERA.

10. I received a B.A. in Economics from the University of Massachusetts and an M.A. in Economics from Boston College. In further graduate studies, I concentrated in econometrics at Boston College and in industrial organization at the University of Connecticut.

11. Prior to joining NERA, I was the Senior Econometrician and then Staff Manager of the Econometrics/Operations Research Analysis group at the Southern New England Telephone Company. At NERA, I have advised clients on rate-of-return and price regulation, interconnection cost and pricing, pricing of access services under competition, and demand and revenue impacts of new telephone rate structures. I have conducted demand studies to support strategic decision-making by major telecommunications companies; analyzed the radio paging industry, and evaluated the investment and marketing programs of telephone companies. I have evaluated damages in antitrust actions and prepared studies for litigation and regulatory proceedings. Finally, I have filed expert testimony before the Federal Communications Commission on appropriate productivity offsets for large and medium size telephone companies and on exchange access reform, and have testified before state regulators on price regulation, infrastructure development, inter-carrier service quality standards, and the fair rate of return on equity.

Dr. Agustin J. Ros

12. My name is Agustin J. Ros. I am a Senior Consultant with the Communications Practice at NERA.

13. I received a B.A. in Economics from Rutgers University and an M.S. and a Ph.D. in Economics from the University of Illinois at Urbana-Champaign.

14. At NERA, I have been an expert witness and submitted expert reports at the state and federal levels on a broad range of issues relating to the telecommunications industry. I have advised U.S. and international clients on price cap regulation, competition policy, interconnection costs, economic principles governing unbundling requirements, and universal service. Overseas, I have helped to arbitrate a price cap dispute between Telmex and the Mexican Commission (COFETEL) and directed a project on total factor productivity and price cap regulation in Peru. I have also developed several interconnection cost models of fixed wireline and fixed wireless networks on behalf of COFETEL. Prior to joining NERA, I was Senior Advisor to the Chairman of the Illinois Commerce Commission and participated in the Federal-State partnership in Telecommunications at the Federal Communications Commission. There, I advised the Common Carrier Bureau on the interconnection provisions of the Telecommunications Act of 1996. At the Illinois Commission, I provided expert advice and policy analysis to the Commission Chairman on the economics and regulation of telecommunications, energy, gas, and water.

15. Recently, I was an Adjunct Instructor at Northeastern University where I taught the Economics of Regulation. I have published a book and articles in several academic and industry journals, and made presentations at various industry and economic forums.

B. Purpose of Reply Declaration

16. In response to the Notice of Proposed Rulemaking ("*NPRM*") released by the Federal Communications Commission ("FCC" or "Commission") in CC Docket Nos. 01-338, 96-98, and 98-147 (collectively, "this proceeding"), dated December 20, 2001, several parties submitted Initial Comments and Declarations on April 5, 2002. A significant portion of those submissions dealt with economic and regulatory aspects of the issues identified in the *NPRM*. At BellSouth Corporation's ("BellSouth's") request, we have

prepared this Reply Declaration to respond to the substantive economic and regulatory comments of various parties. Those parties include, but are not limited to, Allegiance Telecom, Inc. ("Allegiance"), AT&T Corporation ("AT&T"), AT&T Wireless Services, Inc. ("AT&T Wireless"), Nextel Communications, Inc. ("Nextel"), VoiceStream Wireless Corporation ("VoiceStream"), WorldCom, Inc. ("WorldCom"), and Z-Tel Communications, Inc. ("Z-Tel").

17. Our Reply Declaration has two objectives. First, we assess the economic and regulatory principles, arguments, and empirical evidence submitted by other parties. In so doing, we offer alternative perspectives, counter-arguments, and in some cases, corrections or refutations on several of the issues raised by the *NPRM*. Second, in keeping with the comprehensive empirical support provided by the UNE Fact Report of 2002 ("*UNE Fact Report*"), submitted on behalf of BellSouth, SBC Communications, Inc. ("SBC"), Qwest Corporation ("Qwest"), and Verizon Telephone Companies ("Verizon") in this proceeding, we provide empirical evidence documenting the progress of unbundling and local competition in BellSouth's nine-state service territory.

18. This evidence is intended to demonstrate that sufficient progress has been made in the last three years to warrant a substantial relaxation of the Commission's unbundling rules for network elements that currently apply to incumbent local exchange carriers ("ILECs") like BellSouth, SBC, Qwest, and Verizon. Three years have elapsed since the Commission last visited and revised unbundling rules for ILECs.[1] Significant developments have occurred in the telecommunications industry since then, both in terms of technological progress and the advancement of local exchange and wireless competition. These developments have altered many of the "facts on the ground" that had led the Commission, in the aftermath of the Telecommunications Act of 1996 ("1996 Act"), to formulate various regulatory rules—including those pertaining to unbundled network elements ("UNEs")—that it believed would facilitate vigorous

local exchange competition. As a result of the progress made in the last three years, we believe that many of the unbundling rules adopted earlier may no longer apply or may need to be relaxed appropriately.

19. This Reply Declaration is structured as follows. Section II summarizes the economic and regulatory positions of the proponents of continued unbundling of ILEC network elements. These positions, which have been gleaned from the Initial Comments and Declarations of those proponents, attempt to preserve the status quo for unbundling rules and, in effect, deny that the terms of engagement among telecommunications carriers have changed substantially over the past three years. Some, e.g., commercial mobile radio service ("CMRS") carriers, even ask to expand the unbundling rules in ways that are calculated to produce unwarranted advantages that are presently denied them. Section III responds to or refutes these claims using, where possible, empirical evidence at a more general level (such as from the *UNE Fact Report*) or more specifically about the BellSouth region.

[1] FCC, *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking ("*UNE Remand Order*"), November 5, 1999.

G. Claim: "CMRS Carriers are impaired without the availability of dedicated transport on a UNE basis."

1. Introduction

170. The Commission seeks comment on whether section 251(d)(2) requires it to take into account the particular "service" that a requesting carrier seeks to offer.[161] In particular, the Commission wishes to know whether it would be useful to "conduct unbundling analyses for individual services?"[162] More specifically, the Commission asks whether the level of competition for a particular service should matter for determining the need to unbundle ILEC-offered network elements.[163] In this context, the Commission invokes the example of CMRS carriers.[164]

2. Position of unbundling proponents

171. In response to this inquiry, three CMRS carriers, namely, AT&T Wireless, Nextel, and VoiceStream have filed Initial Comments with the Commission. Their principal arguments and positions may be summarized as follows:

1. CMRS carriers are impaired when ILECs deny them dedicated transport provisioned as a UNE to link their Mobile Switching Centers ("MSCs") with their base station cell sites.[165]

2. CMRS carriers have to rely on ILEC transport provisioned as a tariffed special access service, rather than as a UNE. This compels those carriers to charge higher prices to their end-users and, in the process, causes them to experience competitive harm.[166]

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[161] *NPRM*, ¶37.

[162] *Id.*

[163] *NPRM*, ¶38.

[164] "[S]hould the particular characteristics of the CMRS market affect the availability of UNEs to CMRS carriers?" *Id.*

[165] This is the central contention of the three CMRS carriers. See *Comments of AT&T Wireless Services, Inc.* ("*AT&T Wireless Comments*"), *Comments of Nextel Communications, Inc.* ("*Nextel Comments*"), and *Comments of VoiceStream Wireless Corporation* ("*VoiceStream Comments*"), in this proceeding.

[166] *Nextel Comments*, at 4.

3. ILECs enjoy an effective monopoly in the provision of transport facilities needed by CMRS carriers.[167]

4. Ever since the Commission granted pricing flexibility for ILECs' transport services sold as tariffed special access services, ILECs have frequently raised, rather than lowered, their prices.[168]

5. The Commission should not make unbundling rules based on the type of service that a requesting carrier (such as a CMRS carrier) intends to provide.[169]

3. Reply to unbundling proponents

172. Under the standards of impairment adopted by the Commission and discussed in previous sections, CMRS carriers are not, and cannot be, impaired by the provision of ILEC transport as a special access service, rather than as a UNE. Moreover, as explained by BellSouth, inter-office transmission facilities such as dedicated transport may only be provided as UNEs to link switches or wire centers.[170] Base stations in CMRS networks do not qualify as either switches or wire centers, and links between them and MSCs do not qualify as dedicated transport.

173. Technical or network issues aside, there are strong economic reasons for denying the CMRS carriers' request for unbundled ILEC transport. CMRS carriers cannot claim to be impaired in the face of clear evidence of their success as intermodal competitors. All of the available evidence points only to one conclusion about CMRS carriers, namely, that several years of strong growth and falling end-user prices have enabled the wireless industry to emerge as a viable intermodal competitor to ILECs and other wireline carriers. Judging by that evidence, the prognosis for continued strength and competitive progress by CMRS carriers remains promising. If, as they claim in this proceeding, CMRS carriers were impaired at the wholesale level without access to ILEC transport at UNE prices, then their remarkable success at the retail level simply

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[167] *AT&T Wireless Comments*, at 9; *VoiceStream Comments*, at 3.

[168] *AT&T Wireless Comments*, at 12.

[169] *AT&T Wireless Comments*, at 16-19.

[170] *BellSouth Comments*, at 55.

could not have been possible. Significantly, having to obtain the requisite transport from ILECs in the form of special access services has done nothing to constrain either the growth and performance of individual CMRS carriers or of competition among those carriers.

174. The overall health—and improving prospects—of the CMRS segment of the telecommunications industry is best understood by examining data recently released by the Cellular Telecommunications and Internet Association ("CTIA"). These data, summarized in Table 18, demonstrate that CMRS carriers have performed spectacularly on a number of different indicators.

Table 18. Selected Performance Indicators of CMRS Carriers, 1985-2001[171]

CMRS Performance Indicators	2001	2000	1985	Annual growth rate (2000-2001)	Annual average (exponential) growth rate (1985-2001)
Subscribers (Reported)	109,674,358	103,641,514	203,600	23.1%	28.9%
Subscribers (Estimated)	118,397,734	97,035,925	203,600	22.0%	39.8%
Revenues ($ Thousands)	58,726,376	45,295,550	666,782*	29.7%	29.9%*
Gross Investment ($ Thousands)	99,725,965	76,652,358	588,751	30.1%	32.1%
Direct Employment	186,317	159,645	1,697	16.7%	29.4%

* Annual service revenues measured from June 1986 on.

[171] Source: CTIA, *Measuring Wireless Today: CTIA's Semi-Annual Survey*, February 28, 2002, available from http://wireless.fcc.gov/services/cmrs/presentations/Bob_Roche_Feb_28_FCC_presentation.pdf. All data measured in June of various years.

In addition, CMRS carriers' total reported billable minutes-of-use grew to nearly 200 billion in June 2001 from less than 10 billion in June 1992 and less than 50 billion as recently as December 1998.[172] This rapid growth spurt in actual billable usage was made possible by steep declines in prices paid by subscribers for various wireless service plans. That, in turn, has been facilitated by dramatic reductions in the cost that CMRS carriers incur to provide service, competition not merely among themselves but also intermodal competition with alternatives like wireline and Internet-based communication, regulatory change, and rapidly increasing consumer acceptance of the mobility, coverage, and flexibility offered by wireless telephony. Major technological advances and cost reductions have enabled CMRS carriers to both improve service quality and diversify their service offerings. For example, according to one source, the four major CMRS carriers (AT&T Wireless, Verizon Wireless, Cingular Wireless, and Sprint PCS) can now all offer service with a least cost per minute price as low as approximately 10¢ per minute.[173] That, combined with very generous "free-minutes" allowances, flat-rated pricing, no long distance or roaming charges, and nationwide coverage has positioned CMRS carriers to become a strong competitor to traditional wireline service providers like LECs and IXCs. In fact, it appears that after a period of falling average local monthly bills for CMRS subscribers (coinciding with falling prices for wireless service plans), those local monthly bills have actually trended upward in the last two years.[174] This signifies that rising wireless usage has more than offset the decline in prices to produce new gains in revenues per subscriber.[175]

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[172] *Id.*

[173] The Strategis Group, http://wireless.fcc.gov/services/cmrs/presentations/Adam_Guy_FCC_CMRS_Forum.pdf, February 28, 2002.

[174] CTIA, *Measuring Wireless Today: CTIA's Semi-Annual Survey*, February 28, 2002. See *supra*, fn. 171.

[175] All of these trends have been corroborated by the Commission's own efforts at assembling data about the CMRS segment of telecommunications in the U.S. By the end of 2000, wireless telephony in the U.S. experienced an almost 40 percent penetration rate, while over 90 percent of the U.S. population had access to three or more CMRS carriers. See FCC, *In the Matter of Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, Sixth Report ("*Sixth CMRS Report*"), released July 17, 2001, at 5-6. The Commission has also noted the increasing diffusion of digital technology in wireless telephony, the upsurge in competition among CMRS carriers, and average price declines for wireless services of 25 percent in 1999-2000 and 12.3 percent in 2000-2001. *Sixth CMRS Report*, at 6. Also see Table 2 of

175. The spectacular diffusion of CMRS services in the U.S. in recent years acquires a larger significance in the context of overall growth in telecommunications.[176] Recent FCC statistics show that, in July 2001, the subscribership rate for conventional wireline telephony in the U.S. had reached 95.1 percent of all households (or, nearly 107 million households).[177] Unlike wireless telephony, however, the annual gain in the number of wireline-subscribing households has remained relatively flat in recent years, rising approximately 8 percent between 1995 and 2001.[178] However, such flat growth is only to be expected when the subscribership *rate* is already so high (94 percent in 1995 and over 95 percent in 2001).[179] In contrast, a nascent (and now rapidly emerging) market for wireless telephony has prospects for dramatic growth for several more years. To put this into context, it may be noted that at an annual average exponential growth rate of 28.9 percent (see Table 18), wireless subscribership doubles every 2.4 years. At this torrid pace of growth, there can be little doubt that CMRS services have emerged as a strong and viable intermodal competitor (and substitute) for traditional wireline services.[180]

176. Finally, the rapid expansion of coverage and the deployment of nationwide calling plans (along with the forbearance of long distance and roaming charges) signifies the ease with which the larger CMRS carriers have managed to entice subscribers looking for the "anytime, anywhere" connectivity traditionally associated with wireline

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Appendix C in the *Sixth CMRS Report* for comparable state and national wireless subscribership data. This table shows that six out of the nine states in the BellSouth region (namely, Alabama, Florida, Mississippi, North Carolina, South Carolina, and Tennessee) experienced double-digit (and close to national average) rates of wireless subscribership growth between 1999 and 2000.

[176] Even with the recession and other economy-affecting events in 2001, many analysts expected wireless subscribership growth to remain strong, if not at the level of the previous two years. Lehman Brothers expected new subscribers to total 20.6 million in 2001. See *Technology Review*, April 23, 2002 or http://www.technologyreview.com/offthewire/3001_2342002_1.asp. Another source expected the industry to add only about 17 million new wireless subscribers in 2002. See *Wireless Week*, April 15, 2002, or http://www.wirelessweek.com/index.asp?layout=story&articleId=LN45M7-F1D0-00H1-03S7-00000-00.

[177] FCC Industry Analysis Division, *Telephone Subscribership in the United States*, February 2002, Table 1.

[178] *Id.*

[179] *Id.*

[180] See, e.g., the discussion on "Wireless/Wireline Competition" in the *Sixth CMRS Report*, at 32-34.

carriers. The footprints of these carriers now take in not just densely-populated urban areas but extensive stretches of rural areas as well. Some CMRS carriers, in fact, clearly see no handicap in serving rural areas over urban areas, and have as their mission to provide service extensively in rural areas and to become the carriers of last resort—and wireline alternatives—in those areas. For example, in a recent FCC forum, Western Wireless lauded the Commission's efforts to adopt a "market-based approach to regulation" and acknowledged that the result has been to make "CMRS ... the most competitive segment of the telecommunications industry."[181] Having specialized in serving only rural America, Western Wireless provides wireless services (including wireless local loop service) in 118 MSA and RSA markets, and is a designated eligible telecommunications carrier for universal service purposes in 12 states plus the Pine Ridge Indian reservation. Western Wireless claims to offer "rate plans and service offerings that are competitive with [those] of national carriers serving urban areas" and to offer a mix of CDMA, TDMA, and analog technologies (with GSM contemplated) through its network.[182] Western Wireless' example serves as a timely reminder that far from being constrained in extending service in supposedly hard or uneconomical-to-serve areas, some CMRS carriers have found it possible to ring up success stories in the marketplace without the need for additional regulation that would enable access to ILEC networks through mandatory unbundling.

177. At the individual CMRS carrier level, it is worthwhile examining the recent history of AT&T Wireless, Nextel, and VoiceStream, the three CMRS carriers that have petitioned the Commission to extend its unbundling rules to ILEC transport facilities. According to Nextel, all three belong to the club of CMRS carriers with national footprints (of which the three other members are Cingular Wireless, Verizon Wireless, and Sprint PCS).[183] The question that is worth asking is whether there is any indication in the recent financial performances of the three carriers to support the belief that they

[181] Testimony of Mark Rubin, Western Wireless Corporation, at the CMRS Public Forum (for the 7th Annual CMRS Competition Report) organized by the FCC's Wireless Telecommunications Bureau, February 28, 2002.

[182] *Id.*

[183] Nextel Communications Inc. 10-K filed March 29, 2002, at 16.

have been impaired—as per the Commission's criteria for impairment—by ILEC transport not being made available as UNEs. After all, whether or not one believes that the CMRS carriers that perform poorly in retail markets must somehow have been impaired at the wholesale stage, the stronger retail performance of more successful CMRS carriers certainly cannot be attributed to any wholesale-stage impairment. Hence, if the performance of AT&T Wireless, Nextel, and VoiceStream has improved steadily over time, then wholesale-level impairment (allegedly caused by the unavailability of ILEC transport as UNEs) cannot possibly have occurred.

178. Table 19 summarizes the recent financial performance of the three CMRS carriers.

Table 19. Performance Indicators of AT&T Wireless, Nextel, and VoiceStream, 1999-2001[184]

Carrier Performance Indicator	2001	2000	1999	Percent Change 2000-2001	Percent Change 1999-2000	1Q2002	Annualized 1Q2002
AT&T Wireless							
Total subscribers (000)	18,047	15,163	9,567	19	59	19,500	*21,450*
Subscribers added (000)	2,928	2,565	1,531			650	*2,600*
Domestic revenues ($ mill)	13,610	10,446	7,625	30	37		
Domestic service revenues ($ mill)	12,532	9,374	6,823	34	37	3,355	*13,420*
Domestic service revenue per subscriber ($)	694.41	618.22	713.21				
Cost of domestic revenues ($ mill)	n/a	n/a	n/a				
Wholesale cost of domestic service revenues ($ mill)	3,991	3,017	2,531	32	19		
Wholesale cost per subscriber ($)	221.14	198.97	264.57				
EBITDA ($ mill)	3,100	1,876	662	65	183	822	*3,288*
EBITDA margin (%)	24.7	20.0	17.4				
EBITDA per subscriber ($)	171.77	123.72	69.20			42.15	*153.29*
Domestic net service revenue per subscriber ($)	473.26	419.24	448.64				
Nextel							
Total subscribers (000)	8,700	6,680	4,520	30	48	9,202	*10,708*
Subscribers added (000)	1,990	2,160	n/a			502	*2,008*
Domestic revenues ($ mill)	7,014	5,385	3,662	30	47	1,957	*7,828*
Domestic service revenues ($ mill)	6,560	4,979	3,222	32	55		
Domestic service revenue per subscriber ($)	754.02	745.36	712.83				
Cost of domestic revenues ($ mill)	2,538	1,991	1,486	27	34		

[184] Some of the figures in the table are as reported in financial statements of the three carriers, and others have been calculated from original figures that appear on those statements. The sources for the figures in the table include 10-K filings and annual reports of the three carriers in 1999, 2000, and 2001, and various press releases posted on the web sites of the carriers, as well as analyst comments.

Wholesale cost of domestic service revenues ($ mill)	1,290	955	n/a	35	n/a		
Wholesale cost per subscriber ($)	148.28	142.96	n/a				
EBITDA ($ mill)	1,901	1,395	372	36	275	586	*2,344*
EBITDA margin (%)	29.0	28.0	11.5				
EBITDA per subscriber ($)	218.51	208.83	82.30			63.68	*218.90*
Domestic net service revenue per subscriber ($)	605.75	602.40	n/a				
VoiceStream							
Total subscribers (000)	4,558	2,908	846	57	244	5,058	*6,558*
Subscribers added (000)	1,649	2,062	n/a			500	*2,000*
Domestic revenues ($ mill)	3,379	1,935	476	75	306		
Domestic service revenues ($ mill)	2,522	1,283	374	100	243		
Domestic service revenue per subscriber ($)	553.26	441.19	441.77				
Cost of domestic revenues ($ mill)	3,876	2,527	598	53	323		
Wholesale cost of domestic service revenues ($ mill)	758	526	114	44	362		
Wholesale cost per subscriber ($)	166.24	181.05	136.11				
EBITDA ($ mill)	(497)	(592)	(121)	16	-388	64[185]	*256*
EBITDA margin (%)	(19.7)	(46.1)	(32.5)				
EBITDA per subscriber ($)	(109.08)	(203.45)	(143.40)			12.65	*39.04*
Domestic net service revenue per subscriber ($)	387.02	260.14	306.96				

Note: All entries in the shaded columns are percentages. Entries (in particular, percentages) are subject to rounding. Italicized entries are projected (annualized).

[185] Adjusted EBITDA (excluding incentive bonuses related to the Deutsche Telekom AG merger) was $75 million. See *T-Mobile International Reports Detailed First Quarter 2002 Results of VoiceStream*, VoiceStream press release, April 25, 2002. Also available from http://www.voicestream.com/about/press/press_20020425.asp.

Explanation of terms:

Total subscribers: the number of subscribers on record as being served by a carrier as of a certain date, e.g., December 31, 2001, or end-of-first quarter, 2002.[186]

Subscribers added: (in most cases) the net gain in subscribers during a certain period, e.g., a year or a quarter. In some instances, subscriber gains have occurred through acquisition of other CMRS carriers.

Domestic revenues: revenues earned from all domestic operations (including providing service, sales of equipments such as handsets, etc.).

Domestic service revenues: revenues earned purely from the sale of domestic wireless services.[187]

Domestic service revenue per subscriber: the average revenue earned per subscriber from the sale of domestic wireless services.

Cost of domestic revenues: cost to provide wireless services including all wholesale costs, the cost of selling equipment (handsets and accessories) to subscribers, retail costs (selling and marketing), and overhead costs (general and administrative).[188]

Wholesale cost of domestic service revenues: wholesale costs to provide wireless services, which include the carrier's own network operation and maintenance costs, charges paid to other carriers for access, toll, and interconnection, and provisions for uncollectible receivables and changes in non-income related taxes.

Wholesale cost per subscriber: average (per subscriber) wholesale cost of domestic service revenues.

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[186] For present purposes, this includes subscribers for post-paid services only, irrespective of whether they received analog or digital service. Pre-paid service customers are not included.

[187] For present purposes, only revenues from post-paid service and roamer charges are counted in this category. Revenues from pre-paid services are not included.

[188] Other operating expenses like depreciation and amortization and stock-based compensation are not included.

EBITDA: operating income before income taxes and depreciation and amortization. It is calculated as the difference between *domestic revenues* and the *cost of domestic revenues*, and is commonly used as the primary performance measure of a firm's ability to generate positive cash flow.

EBITDA margin: EBITDA as a percent of domestic service revenues.

EBITDA per subscriber: average cash flow per subscriber.

Domestic net service revenue per subscriber: average (per subscriber) margin between domestic service revenues and the wholesale cost of domestic service revenues.

179. In summary, Table 19 demonstrates the following about the three CMRS carriers:

- All three experienced robust subscriber growth between 1999 and 2001.[189] Despite the 2001 recession and slowdowns in the telecommunications industry generally, 1Q2002 results promise continued subscribership growth at or above three-year trends.

- All three (especially VoiceStream) experienced robust revenue growth (both all and service-only revenues) between 1999 and 2001. This happened despite external economic slowdowns, falling prices for wireless services, and increased competition among CMRS carriers. Actual 1Q2002 performance portends healthy revenue gains over prior periods.

- Service revenue per subscriber has trended up for all three carriers between 1999 and 2001. This indicates that, despite falling prices and more generous pricing plans and allowances, subscribers increased usage substantially to keep revenues rising.[190]

- While all three have experienced rising costs (and, in particular, wholesale costs) to provide service, much of that cost increase can be attributed to subscribership growth and expansion of network operations. More significantly, the wholesale costs *per subscriber* of the three carriers have fallen or stayed flat through the 1999-2001 period.

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[189] VoiceStream, in particular, experienced a surge in subscribership (almost 244 percent) after it became independent of Western Wireless, its original parent company. Subsequently, VoiceStream was acquired in 2001 by Deutsche Telekom AG, which brought in additional subscribers on the GSM digital wireless technology standard.

[190] Subsidies on handsets may have made it easier for subscribers to take service or increase usage. Despite lower prices for handsets, the total revenues of the three carriers posted healthy gains as well between 1999-2001.

- The most important performance indicator, EBITDA, has trended rapidly upward for AT&T Wireless and Nextel. Although VoiceStream experienced negative EBITDA between 1999-2001, the long-term trend is toward eventual profitability and positive cash flow. In fact, in 1Q2002, VoiceStream posted $64 million in EBITDA which, despite the indifferent state of the economy, portends well for the carrier's future.

- EBITDA per subscriber has made impressive gains for AT&T Wireless and Nextel, while the negative EBITDA per subscriber for VoiceStream has been attenuated. In fact, based on 1Q2002 experience, VoiceStream could realize almost $54 in EBITDA per subscriber in 2002. Despite the current sluggish economy, Nextel's EBITDA per subscriber in 2002 is likely to be little changed from the 2001 level, while AT&T Wireless' EBITDA per subscriber in 2002 may slip only a little from its 2001 level.

- After a brief dip in 2001, the domestic net service revenue per subscriber moved up impressively for AT&T Wireless and VoiceStream, while it moved up slightly for Nextel.[191]

180. Collectively, these "facts" about the financial performance of the three CMRS carriers point to one central fact: there is absolutely no evidence whatsoever that failure to provide ILEC transport facilities at (below-market) TELRIC-based prices caused substantial harm or, in any way, impaired the ability of the three carriers to acquire subscribers or grow despite difficult economic times. Taken together with the overall evidence about the financial performance of the entire CMRS segment of telecommunications, it is very hard to reach any conclusion supportive of the economic case made by CMRS carriers in this proceeding for being able to obtain ILEC transport on an unbundled basis. The only legitimate conclusion that can be reached, however, is that were such an unbundling request to be granted, the CMRS carriers that are already displaying the best performances in the telecommunications industry will only be handed a generous opportunity to augment their already handsome bottom lines.

[191] This is an alternative to EBITDA per subscriber. It shows the "margin" earned (before taxes, depreciation and amortization, and other expenses) between service revenues and *wholesale* service costs. If a CMRS carrier experiences significant increases in wholesale costs (such as for interconnection and network facilities it owns or leases from ILECs), then this metric should be most sensitive to those cost increases. In contrast, the EBITDA per subscriber, which is based on *total* revenues and costs, may fail to clearly show the impact of changing wholesale costs.

181. It is important to consider just "how much" impaired the CMRS carriers are likely to be if the claims they have made in this proceeding are, indeed, true. In other words, is there an instrument or scenario that captures the predicament that the CMRS carriers supposedly find themselves in without the benefit of unbundled dedicated transport? Some insight into this question may be gained by examining the capital needs and capital expenditure patterns and priorities of the CMRS carriers. After all, as AT&T Wireless explains it, "... the wireless network relies to a large extent on wireline facilities, and especially on ILEC transport."[192] In a similar vein, Nextel admits that point-to-point microwave may be a "limited alternative" to ILEC transport, but CMRS carriers cannot be assured of the microwave option to serve its network needs ubiquitously. However, it concludes: "For this reason, Nextel and other CMRS carriers have largely come to rely upon ILECs to provide wired access between cell sites and CMRS MSCs. As a result, self-provisioning of the transport portion of a CMRS network is not common."[193]

182. While these statements may well demonstrate the central role that dedicated transport plays within a CMRS network (particularly, given the limitations of the microwave alternative), they do *not* sufficiently establish or explain why, from an *economic* standpoint, CMRS carriers cannot feasibly self-provision such transport. Ironically, it *is* clear why, after several years of manifestly successful operations, CMRS carriers have suddenly seized upon an opening provided by the *NPRM* to raise the specter of impairment if ILEC transport is not made available to them as a UNE. To understand why, consider the following claim by Nextel:

> ... ILEC refusal to provide this transport on terms other than as end user special access leaves CMRS carriers without effective recourse. CMRS carriers must obtain dedicated transport services from ILECs under the terms of special access tariffs or under contracts based on those tariffs. This impairs CMRS carriers not only because they must pay higher rates, but also because there is no statutory

[192] *AT&T Wireless Services Comments*, at 24.

[193] *Nextel Comments*, at 6-7.

guarantee that the ILEC will provide its services in a dependable, non-discriminatory fashion.[194]

183. This is patently a plea by the CMRS carriers to be allowed to obtain dedicated transport facilities from ILECs at prices that are lower (perhaps, significantly so) than those they currently pay for special access circuits. If paying the market-based, albeit higher than TELRIC-based, prices for special access circuits impairs and, specifically, causes competitive harm to CMRS carriers, there is certainly no evidence of it. By their own pronouncements, the CMRS carriers make it clear that business has never been better (despite the recent difficult economic times) and, in information they share with their shareholders, the analyst community, or the public, there is never any complaint about being prevented from achieving their goals (financial and competitive) by the failure of ILECs to provide unbundled dedicated transport.

184. For example, John D. Zeglis, AT&T Wireless' Chairman and CEO, recently offered this upbeat assessment:

> AT&T Wireless continued its track record of growth with one of the best quarters of execution ever. We delivered solid gains for the first three months of the year, *despite an increasingly competitive market.* In the first quarter, we gave 650,000 more people an mLife, ending the period with 19.5 million customers, a 24 percent increase over the prior year's quarter, and 2.4 million more customers than we had just six months ago. At the same time, our aggressive programs to retain customers paid off in significant improvements, lowering churn yet again. We also increased our services revenue by nearly 15 percent. And we did it all while continuing a fast-paced deployment of our leading next generation network, which is progressing on schedule and on budget. As of today, we've built our new GSM network in about 60 percent of our footprint, covering a population of nearly 100 million people. We have launched new GSM/GPRS services in 26 major markets with more around the corner. In short, AT&T Wireless is more competitive and is offering our customers more valuable services than we did a year ago. Our network delivers a higher quality of service, our calling plans better meet customer needs, our offers include new advanced services, our target marketing is attracting additional, profitable customers from new segments, and our brand is

[194] *Id.*, at 8. Footnotes omitted.

increasingly trusted to take loyal customers to the next generation of wireless applications and devices.[195]

At about the same time, Tim Donahue, President and CEO of Nextel, made the following statement:

> I am very excited about Nextel's results for the first quarter. We set very aggressive targets for 2002 and we are on track to *meet or exceed them.* Compared with this time last year, subscribers are up 27%, cash flow is up 66%, and the cash flow margin is up to 32%. Nextel continues to lead the industry in subscriber quality, improve our market share and enhance our cash flow. Past investments in network infrastructure, along with technological advancements, are producing the highest network quality and service levels in our history, allowing Nextel to reduce capital spending and providing us with a clear path to positive free cash flow.[196]

Echoing this sentiment, Jim Mooney, Nextel's Executive Vice President and COO stated:

> Nextel is achieving financial and operational balance. Nextel is driving our market share higher and, when compared with last year's first quarter, Nextel grew revenue over 22% and added over $230 million in quarterly cash flow. These results are driven by our industry vertical market segmentation and sales distribution strategies where sales through lower cost channels rose to 20% of total sales. At the same time, we are executing our cost cutting initiatives and strategic alliances aimed at reducing expenses producing an eight percentage point operating cash flow margin improvement over 2001's first quarter. We expect to *continue to reap the benefits of these actions in the coming quarters.*[197]

Finally, Kai-Uwe Ricke, CEO of T-Mobile International and Member of the Board of Management, Deutsche Telekom AG spoke about VoiceStream (its U.S. subsidiary) thus:

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[195] *AT&T Wireless Services Reports Strong First Quarter Services Revenue Increase of Nearly 15 Percent*, AT&T Wireless press release, April 23, 2002. Also available from http://www.attws.com/press/releases/2002_04/042402.html. Emphasis added.

[196] *Nextel Reports Strong First Quarter 2002 Results*, Nextel press release, April 17, 2002. Also available from http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=NXTL&script=410&layout=7&item_id=280044. Emphasis added.

[197] *Id.* Emphasis added.

> VoiceStream achieved positive EBITDA for the first time this quarter while continuing its very strong subscriber growth. VoiceStream achieved the strong growth in EBITDA by managing its costs carefully. VoiceStream's cost drivers and churn are heading in the right direction while ARPU remains steady.[198]
>
> In addition, Robert Dotson, President and COO of VoiceStream, said:
>
> Our Get More subscriber offering continues to be compelling to wireless users. VoiceStream has always been a leader in the consumer market. We are now seeing growth in the business segment as well, which we attribute to our growing national scope, attractive WorldClass International roaming rates with T-Mobile and our competitive advantage of offering the only ubiquitious [sic] high-speed data network (iStream) across our entire footprint. *All of this is leading to continued strong growth for VoiceStream in a highly competitve* [sic] *market.*[199]

185. These confident and celebratory public statements of the most senior officials of the three CMRS carriers do not conjure up a persuasive picture of impaired and competitively harmed entities for which salvation only lies in requiring ILECs to offer dedicated transport on an unbundled basis. While clearly recognizing how competitive the CMRS industry segment is, these officials also identify the particular strengths that their companies have relied on to experience strong growth, namely, investment in new cellular technologies, additional spectrum purchases, product differentiation, new sales channels and marketing strategies, etc. These are not actions of impaired firms, and attempts by the three CMRS carriers to benefit their bottom lines should not be confused with a genuine competitive disadvantage.

186. In the ultimate analysis, the observed choices and actions of CMRS carriers speak louder than words. If dedicated transport facilities are such an integral part of their networks, surely the CMRS carriers would see it in their long run economic interest to replace leased circuits with their own? ILECs do not have a monopoly on fiber or fiber-based facilities. There are no market or regulatory constraints on CMRS carriers acquiring their own facilities. The only likely explanation for their choosing not to do

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[198] *T-Mobile International Reports Detailed First Quarter 2002 Results of VoiceStream*, VoiceStream press release, April 25, 2002.

[199] *Id.* Emphasis added.

so (e.g., VoiceStream claims that 96 percent of its circuits linking base stations with MSCs are leased from ILECs[200]) is that self-provisioning cannot yield significant savings over leasing special access circuits from ILECs. Hence, leasing frees those carriers up to pursue capital expenditures in other parts of their networks, for which economically leased options are *not* available from ILECs.

187. Both AT&T Wireless and Nextel claim to have adequate resources (from their existing cash balances, cash from sales and other operations, and external funds) to finance their capital requirements into the foreseeable future.[201] Particularly illuminating are the priorities that these carriers have for undertaking capital expenditures. AT&T Wireless' capital expenditures in 2001 reached $5 billion, of which 20 percent was directed at their nascent GSM/GPRS data network and the other 80 percent went to its existing TDMA network. About the same level of capital expenditure is expected in 2002, with nearly two-thirds now directed toward the GSM/GPSR network. In 2001, AT&T spent $1.5 billion on next generation network and handset development.[202] Significantly, against these large capital outlays and similar spending on acquisitions and other restructuring, AT&T Wireless spent only $300 million on dedicated transport lines leased from ILECs.[203] This represented only about 7 percent of the nearly $4 billion that AT&T Wireless incurred in wholesale costs to provide wireless service in 2001.

188. Similarly, in 2001, Nextel's capital expenditures reached $2.47 billion and was directed primarily toward network construction activity (placement of switches, transmitter and receiver sites, and related equipment), licenses, acquisitions, etc.[204] It is not clear how much of that spending was channeled into self-provisioning of dedicated transport facilities. In fact, there seems to be little room for such spending in

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[200] *VoiceStream Comments*, at 15.

[201] *AT&T Wireless Annual Report 2001*, at 14; Nextel Communications Inc. 10-K filed March 29, 2002, at 60.

[202] *AT&T Wireless Annual Report 2001*, at 15.

[203] *Id.*, at 17.

[204] Nextel Communications Inc. 10-K filed March 29, 2002, at 60-62.

the future. Among its capital spending priorities are the construction of additional transmitter and receiver sites, increments to system capacity and maintenance of service quality, installation of related switching equipment, enhancement of mobile network coverage around major domestic market areas, enhancements to the existing iDEN technology to increase voice capacity and improve packet delivery speeds, and the deployment of new technologies. Although Nextel does not explicitly report its actual expenses on leased facilities, there does not appear to be overt concern about how its current spending on those facilities is threatening its ability to compete or offer the services of its choosing.

189. The inescapable conclusion from this detailed examination of the circumstances of the three CMRS carriers is that, apart from experiencing the usual teething troubles of a relatively new but rapidly growing industry segment, they have weathered both economic slowdowns and vigorous competition quite well. The prognosis, far from signifying cumulative competitive harm, remains very hopeful, and the CMRS industry segment as a whole seems intent on diversifying its technological standards and offering even more value-added services based on next generation network technologies.

190. More significantly, the CMRS carriers have entered the Commission-sponsored debate over whether unbundling rules should depend on the types of service being offered more with opportunistic intent than with plain and hard facts to bolster their case. In the absence of any rigorous demonstration of how they have been impaired or competitively harmed by existing ILEC leasing policies, and in the face of incontrovertible financial and performance evidence that run contrary to their claims, the CMRS carriers have failed to make a persuasive case to win unbundled access to ILEC dedicated transport facilities. The generalities that lace their economic arguments (e.g., "ILECs have a monopoly over inter-office transport facilities," or "tariffed prices of special access circuits have risen since pricing flexibility was granted to ILECs," or "special access prices cause competitive harm to CMRS carriers") have no empirical support, and the three CMRS carriers have made no effort to provide any.

The CMRS carriers, or representatives of that industry segment, must have the burden to make their case affirmatively with more tangible and credible evidence. Therefore, we conclude that the circumstances of the requesting carrier—in particular, the services it offers—*should* matter for making an enlightened policy decision regarding ILECs' unbundling obligations.

191. Finally, the CMRS providers fail to address the threshold economic issue: whether mandatory unbundling of network elements should be required to support services other than wireline local exchange service. From an economic perspective, the necessary and impair standard (as well as the essential facility standard in antitrust economics) makes explicit reference to the downstream product or service market involved. In theory, mandatory provision of unbundled network elements or essential facilities involves welfare tradeoffs. Costs and inefficiencies are imposed on the suppliers of the network elements that, in principle, are more than offset by the social gains from the competition in the downstream retail markets made possible by the mandatory unbundling requirement. If there is no gain from new competition in a particular downstream retail market, there is no reason to incur the costs of unbundling to support competitors in that market.[205] Thus, because there is likely to be no beneficial increase in competition among CMRS suppliers (or among long distance providers) from making transport available as a UNE (rather than as an ordinary tariffed service), consumers would ultimately be worse off if the unbundling requirements were extended to these markets.

192. This concludes our Reply Declaration.

[205] For example, the railroad bridge in the *Terminal Railroad* case was deemed an essential facility because allowing multiple railroads to use it opened up a number of markets in the Mid-West to multiple competitors. That fact does not imply that the bridge owners should make it available to others for fishing or sightseeing because there would be no offsetting social gain from increased competition in those markets.

Declaration of

Alfred E. Kahn and Timothy J. Tardiff

December 18, 2001

I. INTRODUCTION

1. My name is Alfred E. Kahn. My business address is 308 N. Cayuga Street, Ithaca, NY 14850. I am the Robert Julius Thorne Professor of Political Economy, Emeritus, Cornell University and Special Consultant with National Economic Research Associates, Inc. (NERA). I received my A.B. degree summa cum laude from New York University and my Ph.D. from Yale University, in 1942. I served as Associate Economist with the Antitrust Division of the U.S. Department of Justice in 1941-42; came to Cornell University as Assistant Professor in 1947 and have served successively as Chairman of the Department of Economics, Robert Julius Thorne Professor of Political Economy, member of the Cornell Board of Trustees and Dean of the College of Arts and Sciences. I have been Chairman of the New York State Public Service Commission and of the (U.S.) Civil Aeronautics Board; and in my capacity as Advisor to President Carter on Inflation, I participated actively in the successful efforts of his Administration to deregulate both the trucking industry and the railroads. I am the author of the two-volume *The Economics of Regulation*, reprinted in 1988 by MIT Press, *Letting Go: Deregulating the Process of Deregulation*, published in 1998 by Michigan State University Institute of Public Utilities, *Whom the Gods Would Destroy or How Not to Deregulate*, published this year by the AEI-Brookings Joint Center for Regulatory Studies, and have written and testified extensively in the area of direct economic regulation and particularly of the public utilities. Of especial relevance to my statement here, I am the co-author of *Fair Competition, The Law and Economics of Antitrust Policy*, was a member of the Attorney General's National Committee to Study the Antitrust Laws and the National Commission on Antitrust Laws and Procedures in the

Eisenhower and Carter Administrations, respectively; I have served as consultant with both the Antitrust Division of the Department of Justice and the Federal Trade Commission; I was recently a member of the National Research Council – Transportation Research Board committee charged with reporting to Congress on the state of competition in the airline industry; and I have published numerous articles, particularly in recent years, on the requisites of efficient competition in regulated and previously regulated industries. I attach a copy of my full resume as Attachment A.

2. My name is Timothy J. Tardiff. My business address is One Main Street, Cambridge, MA 02142. I am a Vice President at National Economic Research Associates, Inc. (NERA). I have specialized in telecommunications policy issues for about the last 20 years. My research has included studies of the demand for telephone services, such as local measured service and toll; analysis of the market potential for new telecommunications products and services; assessment of the growing competition for telecommunications services; and evaluation of regulatory frameworks consistent with the growing competitive trends. Most recently, I have participated in interconnection arbitrations, unbundled element proceedings, universal service investigations, and applications by incumbent local exchange carriers for authorization to provide interLATA long-distance pursuant to the Telecommunications Act of 1996, in over 20 states. I attach a copy of my full resume as Attachment B.

3. Advanced telecommunications services are being offered, and will increasingly be offered, by firms that formerly operated in distinct markets and industries (e.g., traditional telephone and cable television service) as well as new firms seeking to share in this apparently huge

potential market. These new offerings include broadband services—such as high-speed access to the Internet, currently provided mainly by cable modems and digital subscriber lines (DSL)—which have the potential to provide new ways for consumers to acquire information, audio and video entertainment and engage in business transactions. They also give businesses new ways of reducing their costs and of reaching consumers with products and services, new and old. These benefits to consumers and businesses are likely to be very large: some research suggests hundreds of billions of dollars annually.[1]

4. These broadband services are truly new, especially for residential and small business customers. By the end of 1998, the FCC counted fewer than 400,000 subscribers—a penetration rate of well under one percent—some 350,000 using cable modems and only 25,000 DSL.[2] Thereafter, in each of the next two years, residential and small business subscribership increased about four-fold, reaching a total of about 6 million by the end of 2000.[3] [4] Some analysts have projected subscribership of 30-40 million by 2005, with cable

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[1] See, for example, Robert E. Litan and Alice M. Rivlin, "Projecting the Economic Impact of the Internet," *American Economic Review*, Vol. 91, No.2, 2001, pp. 313-317 and Robert W. Crandall and Charles L. Jackson, "The $500 Billion Opportunity: The Potential Economic Benefit of Widespread Diffusion of Broadband Internet Access," July 2001.

[2] Federal Communications Commission, *Deployment of Advanced Telecommunications Capability: Second Report*, CC Docket No. 98-146, August 2000.

[3] The respective shares of cable modems and DSL were 71 and 29 percent at the end of 1999 (Federal Communications Commission, Office of Plans and Policy, *Telecommunications @ the Millennium: The Telecom Act Turns Four*, February 8, 2000) and some two-thirds and one-third, respectively, at the end of 2000, with competitive local exchange carriers constituting some 20 percent of the latter group at the end of both 1999 and 2000. The Association of Local Telecommunications Services (ALTS), *The State of Competition in the U.S. Local Telecommunications Marketplace*, February 2000 and *The State of Local Competition 2001*, February 2001.

[4] Although both cable modems and DSL increased sharply during 2000, the former still enjoyed a 2:1 lead by the end of the year. Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, "High-Speed Access for Internet Access: Subscribership as of December 31, 2000," August 2001.

modems maintaining a narrowing lead *in market share*.[5] The FCC's second *Advanced Services* report also describes the inroads made by wireless and satellite services. The clear prospect is a competitive free-for-all among different suppliers and technologies, with the ultimately victorious ones far from clear and only consumers clear winners.

5. While broadband subscribership has continued to grow in 2001, the rate of that growth has declined markedly in not only percentage but also absolute terms. Moreover, the drop-off has been disproportionately large in the case of DSL as contrasted with cable modems.[6] While the total number of residential broadband subscribers added per quarter declined 20 percent—from 1.5 million in the fourth quarter of 2000 to 1.2 million for the first half of 2001—the decline in the new subscriptions to DSL was 35 percent (from 0.7 million to 0.45 million) and to cable modems only 7 percent (from 0.8 million to 0.75 million). The weakening of the U.S. economy doubtless explains part of the overall deceleration; the fact that growth rates for the more heavily regulated DSL services have experienced a much larger decline suggests, however, that current regulations may also be part of the explanation.

6. Whether the full potential of broadband services is realized depends on whether firms that must make huge investments to develop and upgrade the requisite networks have the opportunity to earn returns commensurate with the risks they will face. The amount and type of regulation will be an important determinant of those opportunities. As we explain in more detail below, any regulation of *new services* is problematic, because it increases the

[5] Verizon, *Broadband Fact Report*, December 19, 2001.

[6] *Ibid.*, pp. 16-17.

cost and decreases the attractiveness of offering them. By the same token, relaxing regulation where it is no longer needed can unlock this potential. For example, as we describe in detail below, wireless was successful—providing benefits estimated at $25-$50 billion annually—even though it was regulated through the mid-1990s; since its deregulation at that time, subscribership has increased four-fold, with a commensurate increase in consumer benefits.

7. While both Congress and the FCC have generally recognized that the enormous potential will be much more rapidly and fully realized through competition in the market rather than a regulatory regime, there is a gaping exception to this recognition. While the FCC has generally taken a hands-off position with respect to both the Internet and most means of providing access to it, it has at the same time extended to the broadband services of incumbent local exchange carriers (ILECs) its regulations designed to promote competition for traditional local exchange services. The purpose is, of course, the same as the purpose of the Telecommunications Act in requiring ILECs to make unbundled network elements available, at favorable wholesale prices, in the belief that competitive local exchange carriers (CLECs) would be "impaired" in their ability to compete in downstream markets without such access.

8. Whatever merits regulations such as these have in facilitating efficient competition for traditional telephone services, they are both unnecessary and counterproductive when applied to broadband. As for the former, the essential premise underlying these requirements—namely, the necessity of CLECs having access to the facilities of the ILECs—is invalid in the broadband market. Not only are there alternative sources, as the

FCC has itself conceded; the ILECs are not the dominant suppliers—they have been and remain markedly behind cable modem services. And, on the other side, maintaining, extending, or even keeping open the option of applying regulation asymmetrically only to ILECs will not only dampen their incentives to roll out these services quickly and to introduce new methods of broadband access; it also risks artificially preserving the dominant position of the incumbent cable modem providers.

9. In particular, because it is very difficult, perhaps impossible, to forecast how competition for broadband services will evolve (what technologies will emerge, how successful each will be, what proportion of consumers will choose to subscribe, and how frequently and for what purposes they will use the services), basing regulatory policies on assessments of whether the present deployment is "fast enough," would be a fruitless exercise. No one can possibly know the ultimate size of the market and how it will be supplied. The task of policy is to remove all remedial hindrances to the competitive market's giving us the definitive answers.

II. ECONOMICS OF NEW SERVICES[7]

10. New services, particularly those requiring large investments and/or new technology, offer the prospects of large benefits, but at significant costs and with unusual degrees of risk. The benefits are large precisely because of their novelty. For example, Crandall and Jackson have estimated that wide scale penetration of broadband services (with broadband

[7] Parts of this section are adapted from Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation*, Michigan State University, Institute of Public Utilities, 1998 and Alfred E. Kahn, Timothy J. Tardiff, and Dennis L. Weisman, "The Telecommunications Act at Three Years: an Economic Evaluation of its Implementation by the Federal Communications Commission," *Information Economics and Policy*, Vol. 11, 1999, pp. 319-365.

becoming almost as ubiquitous as ordinary phone service) would provide economic benefits of $400 billion annually in the form of new capabilities, such as shopping, commuter travel and home entertainment.[8]

11. Whether the widescale penetration that delivers such benefits will become a reality depends on potential suppliers—ILECs, cable operators, wireless broadband providers—making the requisite large investments, with no guarantee that their particular technology will prevail in competition with others or that consumers will sufficiently value the services it makes possible. These will include the large investments not only in the electronic equipment necessary to roll out more of their present DSL services over their existing copper loops but possibly the even larger ones in both electronics, fiber optic and wireless facilities capable of providing for greater capacity to carry information.

12. Were it not for the long legacy of telecommunications regulation—necessitated historically by the monopoly of the ILECs in traditional telephone service generally and local access in particular—the proper regulatory treatment of broadband services would be crystal clear: there would be none. The newness of the service, its reliance on risky technologies, the rapid expansion of the market and the leading position of unregulated suppliers all strongly suggest that the FCC's general disposition to keep its hands off the Internet has been fundamentally correct. The investments that the Telecommunications Act seek to encourage are not of a routine character such as may be required to provide plain old telephone service, but extremely costly and risky, both commercially and technologically. As for the former, it is useful to recall the exuberant expectations at AT&T about the

[8] *Op. cit.*

potential of Picturephone some 35 years ago. While until recently analysts had expected broadband subscription to grow at rates resembling those of wireless a decade earlier, with comparable enormous benefits to the public,[9] the recent downturn in growth suggests that establishing the correct broadband policy may be a prerequisite for realizing its full potential. At the same time, there are very large risks about which technology will prevail: it is important to remind ourselves that those benefits are much clearer in hindsight than at the beginning of that decade, as is clearly suggested by the willingness of AT&T to surrender this particular business to the RBOCs at the time of divestiture, its more recent, hugely costly cable company acquisitions and its present attempts to sell them off. As for the technological uncertainty, how many times over the last several years has the consensus view changed about what method of transporting telecommunications signals will prove to be the successful one?

13. Under a proper conception of effective competition, the general rule is that neither new services nor the underlying facilities that produce them should be subject to regulation. The conception of monopoly in the offer of truly new services is a virtual oxymoron. New services offer customers additional alternatives not available to them previously. Their introduction is fundamentally a competitive rather than a monopolistic phenomenon, even though they may be distinctive and the innovator may be in a position to earn supernormal profits from them. To deny an innovator the rewards of being first would inhibit innovation, and it should not matter for these purposes whether the innovator is an incumbent telephone company, an incumbent cable television provider, or a new entrant. A

[9] Coincidentally, revenues for these two services per subscriber are roughly comparable, with wireless in the $55

half-century ago, Schumpeter[10] eloquently expounded—and generalized—the same underlying principle: the "perennial gale of creative destruction" that constitutes the most creative form of competition in a capitalist economy *consists,* at its essence, in the perpetual process of creation and erosion of monopoly positions achieved by innovation, with the prospect of the monopoly that rewards successful innovation providing the essential incentive for innovators and imitators alike. Transient market dominance and monopoly pricing are an essential part of the process:

> The introduction of new methods of production and new commodities is hardly conceivable with perfect—and perfectly prompt—competition from the start. And this means that the bulk of what we call economic progress is incompatible with it. As a matter of fact, perfect competition is and always has been temporarily suspended whenever anything new is being introduced —automatically or by measures devised for the purpose—even in otherwise perfectly competitive conditions (1950, p.105).

14. The more innovative the investments contemplated, the greater the uncertainties, both technological and commercial, the greater the risks, the more important is the prospect of the investor's exclusive enjoyment of the fruits of the ventures that turn out successfully. This proposition and the way in which the FCC's sharing rules conflict with it are most incisively spelled out by Justice Breyer, in his concurring opinion in the *Iowa Utilities Board* case:

> [A] sharing requirement may diminish the original owner's incentive to keep up or to improve the property by depriving the owner of the fruits of the value-creating investment, research, or labor....Nor can one guarantee that firms will undertake the investment necessary to produce complex technological innovations, knowing that any competitive advantage deriving from those innovations will be dissipated by the sharing

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to $95 dollar range from 1988 to 1994 and broadband at about $50 today.

[10] *Capitalism, Socialism and Democracy*, 3rd ed., New York: Harper & Row, 1976, Chapter VII.

> requirement.....Increased sharing by itself does not automatically mean increased competition. It is in the unshared, not in the shared, portions of the enterprise that meaningful competition would likely emerge. Rules that force firms to share every resource or element of a business would create, not competition, but pervasive regulation, for the regulators, not the marketplace, would set the relevant terms.[11]

15. As in the case of broadband, the major contribution of wireless has not been its reduction in the cost of existing ordinary telephone service,[12] but its offer of a new service that allows consumers to communicate in ways virtually unavailable previously—for which consumers were willing to pay high prices in the early years and in explosively growing numbers as prices declined but remained still at premium levels—every year since it was introduced.

16. Economists measure the benefits from a new product or services as the difference between what consumers pay and what they would be willing to pay at the point that they were indifferent between using the service and spending the money elsewhere. For example, the early adopters of cellular service paid several hundred dollars for the phone itself and prices considerably higher than today's for usage.[13] Now, these same subscribers can pay less for a service that is also probably of higher quality. Accordingly, the benefit from this phenomenon is at least as large as the difference between what they used to pay for the amount they used and what they pay today for that old amount, and of course it is enormously increased by the difference between the successively declining prices that successive increments of customers would have been willing to pay and the low prices that they more or less uniformly pay today.

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[11] *AT&T Corp. v. Iowa Utilities Board*, 119 S. Ct. 721, 752 (1999) (Breyer, J. concurring in relevant part).

[12] In fact, it has been only fairly recently that prices have declined to the point where wireless service has become a substantial substitute for ordinary service.

17. Jerry Hausman estimated the benefits of wireless services to consumers in 1994 at $25 to $50 billion annually,[14] or between 1.75 and 3.5 times the annual revenues of about $14 billion.[15] And both have exploded since then: subscribers have increased from about 25 million to over 100 million and revenues from $14 billion to over $50 billion annually.[16] This explosion coincided with two events that substantially relaxed regulatory burdens on wireless providers: (1) the Omnibus Budget Reconciliation Act of 1993, in which Congress deregulated the industry to a great extent, and (2) the increase in the number of providers that the availability of the new PCS spectrum permitted. Applying Hausman's calculations to current volume shows that the annual benefits have grown to a range of $85 billion to $170 billion.

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[13] The FCC reports that the average revenue-per-subscriber declined from about $97 in 1987 to about $45 in 2000.

[14] Jerry A. Hausman, "Valuing the Effect of Regulation on New Services in Telecommunications," Brookings, 1997. Similarly, Rohlfs, et al. estimated the social cost of the 10 to 15 year regulatory delay in licensing cellular systems at more than $86 billion–about 2 percent of GNP in 1983, when cellular service began. Jeffrey H. Rohlfs, Charles L. Jackson, and Tracey E. Kelley, "Estimate of the Loss to the United States Caused by the FCC's Delay in Licensing Cellular Telecommunications," National Economic Research Associates, November 4, 1991.

[15] The major determinant of the relation between revenue and benefit is the price elasticity, with the multiple decreasing as the elasticity increases. This is explained by the fact that when elasticity is high, consumers would be willing to pay little more than the current price.

[16] This expansion appears to be the result of both lower prices and competition shifting the demand curve outward by making services available to more consumers, improving the quality of services, and the like. In fact, the demand curve shift seems to be at least as powerful as the price reduction. For example, if we treat the 25 percent reduction in revenue per subscriber as a price decrease and use Hausman's elasticity of –0.5, then over 80 percent of the growth in volume after 1994 can be attributed to the demand curve shift and less than 20 percent to the price reduction. If instead we take as a measure of the decrease in prices the drop from $0.57 in 1994 to $0.21 in 2000 (Thomas J. Sugrue, "Sixth Annual CMRS Competition Report, Opening Remarks," June 20, 2001), the increase in demand and price reduction share equally in explaining the total expansion of sales. A major benefit of the increased competition since 1994, in addition to its having reduced prices to existing consumers, has been its expansion in the reach of these new services to a much larger customer base.

III. THE CURRENT ASYMMETRICAL REGULATION OF BROADBAND SERVICES INHIBITS INNOVATION AND HARMS CONSUMERS

18. The universal prescription of economists, we submit—other considerations aside[17]—would be that regulators not impose economic regulation on the provision of risky, innovative and/or new services such as broadband. In contrast, the present system has the anomalous characteristic that the leading suppliers, cable operators, are not regulated, while the competitors striving to catch up with them—in both cases endeavors that require very large and risky investments—are still regulated on the basis of what a regulatory agency says is "cost" plus a "reasonable" profit. In addition to the absurdity of shackling a competitor running in second place, the injuries to consumers from perpetuating such asymmetrical regulation are four-fold. *First*, by increasing the costs and risks of only one type of competitor—in effect imposing a tax on particular sources of supply—it makes it less likely that the services those competitors are uniquely qualified to offer will make it to the market, depriving consumers of the possibly enormous benefits of such offerings. *Second*, even if the broadband services offered by alternative providers prove to be close substitutes, handicapping one group could prevent the lower-cost supplier from taking over the share of the market that it would otherwise obtain. *Third*, the regulatory advantage enjoyed by the cable operators could give them an advantage in the provision of services other than broadband—such as video—thereby weakening and conceivably distorting the competition in the supply of such complementary services. *Fourth*, the discouraging effect of the

[17] We cannot of course ignore the fact that some economists are, nevertheless, opposing the deregulation of these services, particularly as it applies to the incumbent telephone companies, in the interest of preserving competitive opportunities for downstream rivals. We address ourselves specifically to that purpose of the Telecommunications Act in pars. 25-38, below.

Commission's regulation of the ILECs' broadband offerings is not confined to risk-taking innovations by them; it is equally destructive of the other part of the process of competitive innovations—the efforts of rivals of the successful innovator, by their own efforts, to invent around and surpass the originator.

19. The current broadband regulatory scheme as applied to ILECs appears to be designed not to provide incentives for them to compete against cable modems and other facilities-based providers but to provide CLECs an opportunity to get a piece of the action by free-riding on their facilities. The fact is, however, that the greater public benefits flow from facilities-based competition than from the efforts of competitors reselling the ILEC facilities, taking advantage of regulatorily-created opportunities; and it is precisely that facilities-based competition that the present rules both distort and discourage.

A. Cable Modems are Essentially Unregulated

20. In both its public pronouncements[18] and its specific rulings, the FCC has consistently maintained a hands-off-the-Internet position with regard to cable modem services,[19] a position it established early and articulated clearly in approving AT&T's acquisition of TCI, then the largest cable television company. The issues were poignantly posed by the plans of AT&T for a multi-billion dollar upgrading of the TCI cable in order to provide local, Internet and advanced video services; by the mounting pressures on the Commission

[18] See, for example, "'Open Access' Review Would be 'Premature,' Kennard Tells Dingell," *Telecommunications Reports*, January 3, 2000, pp. 5-6 and Federal Communications Commission, In the Matter of Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, Notice of Inquiry, GEN Docket No. 00-185, September 28, 2000, par. 4.

[19] The FCC has undertaken an ongoing investigation of this policy, apparently motivated at least in part by open access rulings by local governments and differing interpretations by federal courts. *Ibid.*, par. 14.

by competitors and public agencies to condition its approval of the merger on AT&T's giving competitors access to those facilities—presumably at FCC-determined rates; and by the equally costly and risky plans of the incumbent telephone companies to compete in these same markets by digitalizing their subscriber access lines. AT&T strenuously resisted the proposals to impose such a condition upon it.[20] As its experts argued, in our view correctly:

> It would be against the public interest to subject the parties' last mile broadband data transport facilities to any form of regulation at this time....There are many competitors, including the ILECs, that are actively developing broadband transport services...The xDSL services that are currently being deployed by the incumbent LECs alone constitute a significant and attractive commercial alternative to the internet cable services that TCI and others offer...The] demand to unbundle broadband transport will engender intrusive regulation of an emerging new service that requires massive entrepreneurial investments and whose marketplace success is far from assured...Forced unbundling with its attendant regulatory uncertainty would likely slow down the investment in the development of broadband last mile investment. Investing under the shadow of uncertain regulatory rules in an innovative service exacerbates the already substantial risks associated with that investment.[21]

The FCC concurred, presumably in the belief that imposition of such a sharing obligation would be incompatible with Congress's deregulation of the cable companies, with the need to encourage costly investment in upgrading their telecommunications capabilities and, therefore, with Schumpeterian competition. In its later approval of AT&T's acquisition of

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[20] *See* Bryan Gruley, *Must AT&T Give Internet Rivals Access To TCI's Network?* WALL ST. J., Jan. 15, 1999, at A1.

[21] Declaration of Professors Janusz A. Ordover and Robert W. Willig, attached to AT&T's and TCI's Joint Reply to Comments and Joint Opposition to petitions to Deny or to Impose Conditions, *In the Matter of Joint Application of AT&T Corp. and Tele-Communications, Inc. for Transfer of Control to AT&T of Licenses and Authorizations Held by TCI and its Affiliates or Subsidiaries*, CS Docket No. 98-178, November 13, 1998. Ordover and Willig make no effort to reconcile their compelling argument here that government restrictions can stifle innovation incentives with their previous advocacy of TELRIC pricing for access to ILEC networks.

MediaOne, the FCC once again rejected mandatory sharing, emphasizing the competition among both broadband access providers and Internet Service Providers (ISPs) as a major part of its rationale:

> [W]e find that there is significant actual and potential competition from both broadband service providers and from unaffiliated ISPs that may gain access to the merged firm's cable systems.[22]
>
> The evidence of growing competition from both alternative broadband providers and unaffiliated ISPs gaining access to cable and other broadband networks indicates that any action taken by the merged firm to disfavor unaffiliated broadband content and applications providers is likely to threaten the networks' ability to attract and retain customers.[23]

21. The FCC currently regulates the ILECs' broadband services in two ways: (1) it requires that the prices they charge their end-user customers and Internet Service Providers (ISPs)[24] be cost-based and (2) it requires them to make certain parts of their networks available to competitors at prescribed wholesale prices. Indeed, if anything, these unbundling requirements and concomitant pricing rules become even more onerous when the ILECs contemplate upgrades to their networks that would both extend broadband services to more customers and provide the capability for more services (e.g., video). The contrast with the explicit exemption of the dominant cable modem services could not be more glaring.

22. While the continued application of traditional regulatory pricing standards to ILECs' retail broadband prices (for services offered to end-users and ISPs)[25] prescribes the rate at which

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[22] Federal Communications Commission, In the Matter of Applications for Consent to the Transfer of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor to AT&T Corp., Transferee, Memorandum Opinion and Order, CC Docket No. 99-251, June 6, 2000, Par. 116.

[23] *Ibid.*, par. 123

[24] Indeed, while ILECs are required to provide services to ISPs at regulated prices, the FCC has not even required that cable television providers provide access to ISPs at *any* price.

[25] Federal Communications Commission, In the Matter of GTE Operating Companies GTOC Tariff No. 1, GTOC Transmittal No. 1148, Memorandum Opinion and Order, CC Docket No. 98-79, October 30, 1998, par. 32.

they are permitted to recover the large investments needed to provide these services, competitive providers are free to set prices as market conditions permit or dictate. And the ILEC must offer any services that it sells directly to end users also to competitors, at a prescribed resale discount.

23. To date, the FCC has considered the facilities used by ILECs to provide broadband services to be telecommunications services, and thus potentially subject to being offered on an unbundled basis to competitors. The requirement that the ILECs actually unbundle the facilities that provide broadband services and make them available to competitors is subject to the FCC's finding that particular elements satisfy the "necessary" and "impair" requirements of Section 251 of the Telecommunications Act. In that event, they become subject to the pricing standard specified in Section 252, which the FCC has interpreted to be its blank-slate total-service long-run incremental cost (TELRIC). To date, the Commission has made the following pertinent unbundling decisions:

    - Because the electronics necessary to provide broadband capability over copper loops are widely available and easy for CLECs to deploy, it declined to order that packet switching and DSLAMs be unbundled, under at least some circumstances, when customers are served by copper loops.[26]

Federal Communications Commission, In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability, Second Report and Order, CC Docket No. 98-147, November 9, 1999, par. 21.

[26] Federal Communications Commission, In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order and Fourth Notice of Proposed Rulemaking, CC Docket No. 96-98, November 5, 1999, pars. 306-317. Even in this case, the Commission's action could be viewed as tentative in that it qualified its action with the phrase "at this time (par. 306)," strongly suggesting that it reserved the right to unbundle in the future.

- When, however, ILECs offer DSL services over loops that are part copper (distribution) and part fiber (feeder) and they are not able to offer collocation space in their remote terminals, they must unbundle their DSLAMs and packet switches.[27]
- Shortly after refraining from mandatory unbundling of the electronic equipment that provides DSL services, the FCC *did* require the ILECs to unbundle the high frequency part of a loop and offer it at low regulated prices to CLECs wishing to offer DSL—thereby sharing that line with the ILEC providing ordinary voice service.[28]

24. The situations in which these asymmetrical unbundling obligations impinge most heavily on the ILECs are precisely the ones in which those obligations dampen their incentives to upgrade their networks in order to extend broadband services to more customers and enhance the offerings to all of them—namely, the ones involving application of technologies other than existing copper loops. They do so: (1) by effectively allowing CLECs to share in the rewards from the new investments while paying only bare-bones TELRIC prices for that privilege, (2) imposing the costs of accommodating those CLECs—for example, the costs of increasingly sophisticated operations support systems—only on the ILECs and not on their other facilities-based competitors, and, (3), in particular, effectively perpetuating mandatory unbundling as new technologies move potential points of interconnection out of the central office (where space is more available than at other

[27] *Ibid.*, par. 313. At the time of the order, the most current ARMIS data (1998) showed that about 17 percent of the lines in Verizon's (pre-GTE merger) territory had fiber feeder. In the two years since then, such lines have accounted for 75 percent of the growth in the total.

[28] Federal Communications Commission, In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability and Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order in CC Docket No. 98-147 and Fourth Report and Order in CC Docket No. 96-98, December 9, 1999. In making that determination, the FCC employed an extremely narrow market definition—confining it to customers that want ordinary voice and DSL service over a single line (par. 39). And in determining what types of entrants would be "impaired" without line sharing, the FCC focused on special-purpose providers that choose to piggyback on ILEC voice customers. Ironically, in light of the fact that parties opposed to line sharing had argued that (1) a CLEC could choose to exploit the same economies of scope as an ILEC by buying a loop and offering both voice and DSL and (2) the DSL-only CLEC could cream-skim above cost voice services by transporting them over its packet switches, the FCC admitted

points) and farther into the network, where collocation arrangements are decreasingly available and/or more costly.[29]

B. The Impropriety and Harmful Effects of Extending Mandatory Sharing to ILEC Broadband Facilities

25. There is no disagreement with the proposition, embodied in the Act, that incumbent telephone companies should be required to make available to their competitors at a reasonable cost-based price preexisting facilities, inherited from their franchised monopolies, that are truly essential if the challengers are to compete with them. To the extent, however, that (1) it is economically feasible for competitors to obtain access to such facilities or practical substitutes from other sources or (2) the incumbents acquired or created them in competition with other providers, and, especially (3) if that acquisition has involved or continues to involve costly, risky innovation, enforcement of an obligation to share them or the advantages they confer with rivals can be anticompetitive.

26. In the case of broadband services, there is a strong case for the position that the obligation to share should be confined to essential facilities, strictly defined. The essence of competition is the attempt to develop and exploit the competitive advantages that successful innovation provides; to require their sharing in instances in which that quest has been successful, particularly where the quest involved big risks, would therefore discourage competition itself.

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that these DSL-only entrants would indeed be able to attain scope economies through the cream-skimming that the ILEC opponents had identified (par. 57)

[29] This is because under the FCC's rules the offer of collocation exempts an ILEC from obligations to unbundle their DSLAMs and packet switches; but these recent developments moving interconnection points further into the network make the collocation exemption decreasingly available to them.

27. Some have argued for a less strict standard in the context of the introduction of competition into public utility industries: that typically an incumbent company not only will control some facilities truly "essential" to its rivals but will also enjoy economies of scale or scope not because of superior enterprise on its part but merely because of its inherited franchised monopoly, and that requiring it to share the benefit of those facilities with rivals at a compensatory price would therefore not entail penalizing successful competitive efforts. By exactly the same logic, however, there is no basis for applying the sharing requirement to the subscriber access facilities of the local telephone companies and not to the access lines of their cable competitors, whose "monopoly" of which is similarly attributable to their historical status as franchised local monopolists.

28. Moreover, the somewhat more liberal sharing requirement of the telephone companies must not be permitted to obscure the fundamental propositions to which it provides the exception. First, it justifies mandatory sharing only of facilities or capabilities carried over from and attributable to the public utility past. Second, wherever mandatory sharing, for the sake of jump-starting the entry of competitors, would interfere with the more creative and dynamic investment henceforward in facilities-based competitive entry and innovation by incumbents and challengers alike, it is the latter that must take primacy. As Justice Breyer observed in concurring with the U.S. Supreme Court's decision overturning the FCC's 1996 Local Competition Order's requirement that the ILECs provide competitors with all network elements to which access is technically feasible, if rivals can share whatever ILEC facilities they ask for that can feasibly be provided, *at rock-bottom prices*—with their mere asking satisfying the conditions for mandatory sharing set forth in the Act—

it cannot but have a discouraging effect on their own initiative and innovation and, equally, on the willingness and ability of the ILECs themselves to undertake large risky investments in developing and incorporating new technology in their networks. In particular, much of the investment necessary for ILECs to extend broadband services to more customers and to provide broadband services with new capabilities entail not simple electronic upgrades to existing copper lines, but deployment of new ways to incorporate fiber optics and wireless technologies into their networks.

29. As the foregoing reference to "rock-bottom prices" suggests, the disincentive to innovation posed by the FCC's standards for identifying UNEs for mandatory sharing is grossly accentuated by the costing method it has prescribed for pricing them. This method, the estimated total-service long-run incremental cost (TELRIC) of a hypothetical most efficient new entrant, writing as it were on a blank slate, essentially ignores the actual incremental costs of the incumbent suppliers.[30]

30. The wide differences produced by the Commission's prescribed models, consistently lower than estimates by the incumbent companies of their actual incremental costs, cannot be attributed to the natural tendency of regulators to underestimate and regulatees to exaggerate the costs on the basis of which rates are to be set. The Commission has rationalized its endorsing of the models in part on the basis that it expected the incremental costs of the incumbent companies to reflect inefficiencies on their part. But that rationale, automatically assumed to explain the difference, is absurd. Not only is it irrational, in terms

[30] "Why should these firms invest in new, often risky technology for delivering advanced, high-speed services if they are to be required to offer any such new facilities to their rivals at cost"—moreover, "not the Company's

of the entire economic case for basing efficient prices on the actual marginal costs of incumbents; it also ignores the likelihood that an existing network, maximally efficient as of the time of its installation, will, because of the interdependencies between its various elements, contain some that could be replaced by more efficient elements with lower incremental costs only as part of a totally new system. The least-cost expansion path of an incumbent telephone company will necessarily be constrained by its inherited total complement of facilities, so that it could take advantage of the putatively lower incremental cost of an individual element only by taking on the additional cost of redesigning its entire network. That neither party believes that the blank slate estimates approximate either the ILECs' own incremental costs or those that would actually prevail under competition is demonstrated by the fact that neither of them actually follows the logical implications of its results, even though it would be the obligation of the former and in the clear interest of the latter to do so. If commissions that still regulate on a rate-base, rate of return basis believed those results, or that they reflected inefficiencies on the part of the incumbents, they would be derelict if they failed either to order the companies to scrap their existing facilities forthwith and take the lower incremental cost route dictated by those models or disallow a large portion of their rate base on grounds of imprudence. That they do not do either of these can only be if they fail to recognize this opportunity, or recognize that the difference between the estimated blank slate incremental costs of an individual element and those of the incumbent need not at all reflect inefficiency on the part of the latter; that adopting the hypothetical lowest cost expansion path for that element alone will be most unlikely to

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actual cost," but "at prices that reflect *most efficient* technology?" Robert W. Crandall, "The Telecom Act's Phone-y Deregulation," *Wall Street Journal*, January 27, 1999.

represent the lowest cost expansion path actually available to even the most efficient company. And if the companies—most of them subject to price cap regulation—believed them, they would be derelict in their obligations to stockholders if they did not likewise do so, abandoning all their present facilities and availing themselves of the assertedly lower present and future costs of the TELRIC blank slate path.

31. Further, as long as broadband services are subject to regulatory pricing and unbundling obligations, the possibility remains that an ILEC could upgrade and/or change its network at considerable risk and, on the ground that competitors would be impaired in their offer of services using these capabilities, be confronted with an obligation to unbundle those new capabilities and make them available to CLECs at bare-bones TELRIC prices.

32. This possibility is by no means merely hypothetical. After all, it is extremely unlikely that Congress had DSL services in mind when it developed the Section 251 requirements. Yet the FCC did not hesitate to apply those requirements—presumably developed with voice services in mind—to advanced broadband services when it ordered line-sharing. Further, as we described earlier, even when it refrained from unbundling packet switching where copper loops are available, the FCC qualified its action with the wording "at this time."[31]

33. In light of the lead that cable modem services enjoy and the FCC's decision to refrain from regulating them, competitive parity would call for a corresponding relaxation with respect to DSL services of the ILECs. The same consideration would argue for freeing them,

[31] One of the facts the FCC considered was that because ILECs did not have a large market share in broadband services, a CLEC would have the benefit of similar scale economies in providing packet switching (par. 308). This reasoning leaves open the possibility that if ILECs were "too successful" in competing for DSL, they could ultimately be deemed to have a scale economy advantage that could then possibly be used to justify mandatory unbundling.

specifically, from the obligation to share, especially at prices reflecting the FCC's hypothetical, ideally efficient firm standard.

34. Consider the anomaly of expecting the incumbent local telephone companies to incur these costs and handicaps in competition with giants such as AT&T—the largest provider of cable television and broadband services. If their new offerings lose out to that competition, they could recover none of the costs in the FCC-dictated charges for their network elements, because *an ideally-efficient firm never fails*! Should their new services instead prevail, they would be required to make those elements available to would-be entrants at wholesale prices based on the efficient-firm cost standard, with costs of capital typically set at traditional public utility levels. In its recent supplement on "Innovation in Industry," *The Economist* cites an American study which found, in nice contrast, "that the overall rate of return for some 17 successful innovations made in the 1970s averaged 56%."[32] What incumbent telephone company would undertake costly and risky innovations in the face of such a prospect of grossly asymmetrical treatment of successes and failures?[33]

35. It may appear anomalous, in view of the already manifest demand of subscribers for high-speed Internet access and new video services, among others, to point out that the losses consumers suffer from regulatory policies that have discouraged innovation are not directly

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[32] "Innovation in Industry," Supplement to *The Economist*, February 20, 1999.

[33] It is not only in their effect on the *incentives* of the ILECs to undertake costly and risky investment in modernizing their networks that the FCC's sharing and network element pricing are likely to prove so harmful. They could also severely impair the *ability* of the incumbents to finance such ventures, by sharply reducing their internal cash flow: retained earnings are frequently the preferred means of financing such risky large-scale investment projects. See K.A. Froot, D.S. Scharfstein and J.C. Stein, "A Framework for Risk Management," *Harvard Business Review*, November-December 1994. S. Fazzari, R.G. Hubbard, B. and Petersen, "Financing Constraints and Corporate Investment," *Brookings Papers on Economic Activity 1*, 1988, report that retained earnings constitute more than 70 percent of the source of funds for corporate investment (p.

observable. The essential evil of such policies is that they discourage or delay the introduction of services that cannot be predicted beforehand. The costs to consumers can be enormous.[34]

36. Moreover, competition alone can be relied upon to provide opportunities for CLECs requiring access to unbundled broadband facilities of the incumbents and to offer consumers choice among competing Internet service providers (ISPs), if their offerings can survive the competitive test. If transport facilities are most efficiently utilized through unbundling arrangements, providers competing with one another will not require regulatory compulsion to enter into them. Similarly, the competition that will emerge from relying primarily on markets rather than regulation will also provide customers with choice among ISPs, because it will be in the competitive interest of access suppliers to provide it. The more competitive the market is, the more sufficient are the incentives of facilities-based providers to negotiate such arrangements. In a competitive market, with multiple platforms available for providing service, if one provider withholds its cooperation from independent ISPs in the hope of vertically extending its control from transport to content, the ISPs can work with its rivals, who will thereby gain a competitive advantage. The critical point is that where, as here, a market is competitive, market forces are sufficient to encourage participants to reach arrangements that will maximize consumer welfare. It is strongly preferable that all such arrangements be negotiated on mutually beneficial terms rather than on terms set by regulators.

147, Table 1) and that on average firms reduce their capital expenditures by more than 36 cents for each $1 reduction in cash flow (p. 167, Table 4).

37. These considerations weigh strongly against any requirement that ILECs unbundle facilities such as access to fiber optics and electronics in remote terminals that require large new investments. In contrast, the logic of the FCC's requiring ILECs to make their existing copper loops available to competitors for access to the high-frequency portion of the spectrum may seem unexceptionable and not inconsistent with dynamic, innovative competition: the incumbents enjoy that opportunity merely because of their inherited, historic control of their copper-wired access networks and there is no immediately apparent reason to permit them to deny competitors access to those capabilities.

38. The Commission's ordering of mandatory provision of such access fails, however, to take into account three critical facts and counter-considerations:

- In the offer of broadband services, the ILECs are not only in intense competition with many other companies offering high-speed access, most importantly to the Internet, via cable, satellite and wireless transmission; they are markedly behind their main competitors, the cable companies.
- To compete in this market, the ILECs are indeed making very large risky investments—to the tune of billions of dollars a year—to incorporate DSL capabilities in their lines. The obligation to offer competitive access providers use of the high-frequency portion of those lines—thereby excluding their own use of the lines for that purpose—clearly biases the economics of that decision, because, unlike providers of cable modems, the ILECs would be forced to share potential DSL volumes with CLECs, who in turn would receive access to customers at very attractive prices (because of line sharing). It particularly skews the economics of their competition with the cable companies, which have likewise inherited from their previous monopolies the capability of using their coaxial cable for broadband access, without being subject to any such sharing obligation, and have a much larger portion of the market than the ILECs.
- The FCC's decision in effect assumes that the optimum telephone company network will remain as it is—predominantly copper subscriber loops; but in fact, to compete in this and other markets, the ILECs will have to upgrade their networks

[34] Hausman, *op. cit.*, estimated that the annual economic welfare losses associated with the delay of voice messaging were on the order of $1.3 billion.

substantially, particularly by installing a great deal of fiber optics and associated electronics.[35] To the extent they do that, it would disable the CLECs' DSL services now provided over copper loops; so continuation of a general line-sharing obligation in effect requires the incumbents to maintain two networks—or to unbundle the fiber as well—precisely the kind of extremely expensive risky new investment to which the logic of mandatory network element sharing is least applicable and most inhibiting of dynamic competition.

IV. CONCLUSION

39. Whatever the merits of the intention of the Telecommunications Act to open local telephone markets to competition, extending the unbundling and sharing obligations of the incumbent telephone companies to broadband transmission of data, including Internet access, is not conducive to efficient competition for broadband services.

40. Moreover, the underlying rationale that the incumbents enjoy monopolistic control over facilities necessary for the challengers to compete with them in this market is simply not correct.

41. On the contrary, extension of those requirements to the ILECs, particularly at the FCC's prescribed TELRIC prices, can only severely handicap them in competing with the incumbent cable companies, who are—properly—subject to no such obligations and now have a far greater share of that market.

42. The result can only be a severe impediment to the very large risky investments in exploiting the almost inconceivably large potential benefits of this new technology. Far from being a logical part of a program to encourage broadband competition—and competitive innovation in particular—it can only discourage that process.

[35] In fact, as we reported earlier, three-quarters of the recent growth in lines for Verizon is accounted for by lines with some fiber.